JAPAN

TRADE SUMMARY

The Japanese economy continues to be characterized by low economic growth, weak demand for imports, and excessive over-regulation. Largely as a consequence of the sluggish demand in Japan and strong growth of the U.S. economy, the U.S. goods trade deficit with Japan jumped to $73.9 billion, up 15.5 percent from the 1998 level of $64 billion. U.S. merchandise exports to Japan totaled $57.5 billion, declining 0.6 percent in 1999. In contrast, U.S. imports from Japan climbed 7.9 percent in 1999 to $131.4 billion. The stock of U.S. foreign direct investment in Japan in 1998 was $38.2 billion, an increase of 13.1 percent from 1997 levels. This investment is mainly in the manufacturing, finance, and wholesale sectors.

OVERVIEW

The Clinton Administration attaches top priority to opening Japan's markets to U.S. goods and services. Our multifaceted strategy to achieve this goal has helped boost U.S. exports to Japan by 20 percent over the last seven years. In line with this objective, the United States continues to stress the vital need for implementation of fiscal stimulus and reform of Japan's financial sector, and urges that Japan continue to use all available macroeconomic policy tools, take steps to strengthen its financial system, and implement comprehensive deregulation and market-opening initiatives. Serious actions by Japan in these areas are critical to attaining a self-sustained and robust economic recovery.

To open Japan's market, the United States has pursued a multi-faceted approach which has centered upon: (1) encouraging major structural reform and deregulation to open more sectors of Japan's economy to competition; (2) negotiating new trade agreements; (3) monitoring and enforcing existing trade agreements covering key sectors, including autos and auto parts, insurance, and government procurement; and (4) addressing concerns through regional and multilateral fora.

Our comprehensive approach to the economic relationship with Japan was first outlined in the United States-Japan Framework for a New Economic Partnership ("Framework Agreement"), signed by President Clinton and then-Prime Minister Miyazawa in July 1993. This agreement allowed for the United States and Japan to simultaneously address sector-specific market access barriers, cross-cutting structural issues, and macroeconomic issues in order to make meaningful progress in opening Japan's market. While Japan has reduced its formal tariff rates on imports to very low levels, it maintains a wide range of other market access barriers including non-transparent administrative practices and procedures; discriminatory standards; exclusionary business practices; and a business environment that protects domestic companies and restricts the free flow of competitive foreign goods into its market. An important innovation of the Framework Agreement was its emphasis on objective quantitative and qualitative criteria for monitoring the agreements, which allow both governments to more accurately assess progress under the agreements.

Since 1993, the United States has concluded 38 trade agreements with Japan – including three in 1999 – covering a wide variety of sectors from autos and auto parts, insurance, civil aviation and harbor practices, to agricultural products, entertainment and high technology. These agreements also address broad structural issues, such as distribution, competition policy, and investment. In each case, the agreements offer new sales opportunities to U.S. exporters and to others with competitive products and services to offer, as well as to Japanese producers and consumers. Indeed, U.S. market share has increased substantially since 1993 in a number of sectors, including semiconductors, medical and telecommunications equipment, and auto parts as a result of the significant progress made under these bilateral agreements.

Building on the Framework Agreement, President Clinton and then-Prime Minister Hashimoto initiated in June 1997 the Enhanced Initiative on Deregulation and Competition Policy ("Enhanced Initiative"), which has become the main vehicle for bilateral efforts to

promote comprehensive deregulation and strengthen Japan's competition policy. In May 1999, the United States and Japan announced a Second Joint Status Report under the Enhanced Initiative detailing deregulation steps in the telecommunications, housing, financial services, medical devices and pharmaceutical products, and energy sectors. Japan also agreed to implement concrete measures designed to address cross-cutting structural concerns relating to competition policy, distribution, and transparency issues.

In October 1999, the United States provided Japan with a 45-page submission calling for the adoption of bold regulatory reforms to further open Japan's economy and increase market access for U.S. and other foreign firms. Both Governments are seeking to complete a Third Joint Status Report by March 31, 2000 that details an additional set of Japanese deregulatory measures which builds upon the extensive achievements made to date under the first two years of the Initiative.

The United States successfully concluded a new bilateral procurement agreement in July 1999 that calls for open, non-discriminatory, and transparent procurement by the four successor Nippon Telegraph and Telephone (NTT) companies, created upon the restructuring of NTT. Together, these companies constitute Japan's largest telecommunications equipment purchasers. In April 1999, the United States and Japan also issued an investment report highlighting measures to reform Japan's structural and regulatory policies with the aim of creating a more dynamic foreign direct investment climate in Japan.

The United States continued to focus attention in 1999 on the monitoring and enforcement of existing agreements to ensure their complete and successful implementation, urging Japan to make progress on our bilateral agreements including those covering autos and auto parts; insurance; construction; and other government procurement. While Japan's economic slowdown has interrupted progress in many sectors over the past couple of years, the United States remains committed to closely monitoring Japanese implementation of our trade agreements to ensure that U.S. rights under these agreements are enforced. The United States also focused heavily on steel trade policies in 1999. Although steel imports from Japan in 1999 declined by 54 percent from the previous year, the United States continues to monitor Japanese steel import levels closely to ensure that they revert to pre-crisis levels on a sustained basis.

In addition, the United States continued to call on Japan to provide meaningful access to its photographic film and paper sector through its market-opening initiative announced in February 1998. The United States released its second semi-annual film monitoring report in June 1999 reviewing Japan's implementation of formal representations it made to the WTO regarding the openness of its photographic film and paper market. While the report recognized and welcomed some of the pro-competitive measures implemented by Japan, it underscored, among other things, the need for additional progress to open the Japanese photographic film and paper market. The United States plans to issue its next monitoring report in the Spring of 2000.

Throughout 1999, the United States also relied on multilateral and regional fora, including the World Trade Organization (WTO) and the Asia-Pacific Economic Cooperation (APEC) forum, in order to achieve the Administration's market-opening goals. Moreover, the United States continued to invoke the WTO Dispute Settlement Mechanism to address problems related to market access barriers in Japan. In February 1999, the WTO Appellate Body upheld a WTO dispute panel ruling that found in favor of the United States in a case against Japan's unfairly burdensome and discriminatory requirements on varietal testing of fruits exported to Japan. The United States and Japan continue to consult on Japan's implementation of the WTO's rulings and recommendations.

Japan and Deregulation

Despite Japan's recent deregulation efforts, the Japanese economy remains burdened by

unnecessary, costly, and excessive regulations that cover about 40 percent of all economic activity in Japan. Excessive regulation in Japan – including price controls, burdensome testing and certification requirements and unconventional standards – restrains economic growth, raises the cost of doing business in Japan, prevents competition from cultivating market-based efficiencies in the private sector, and impedes imports. Over-regulation also raises prices and lowers the cost of living for Japanese consumers. The Government of Japan estimates that if its current deregulation plans are fully implemented, Japan's GDP would grow by an additional 0.9 percent annually during Japanese Fiscal Year (JFY) 1998-2003, while the ratio of Japan's current account surplus to its GDP would fall by 0.9 percent. In January 2000, Japan's Economic Planning Agency released a study which determined that deregulation steps implemented since 1989 in eight key sectors generated roughly $82 billion in savings for Japanese consumers. The study also calculated that deregulation in the domestic telecommunications and electricity sectors alone saved the average Japanese family of four roughly $453 in 1998.

In addition to slowing growth in Japan, government over-regulation lies at the heart of many market access problems faced by U.S. companies doing business in Japan. Some regulations are aimed squarely at imports; others are part of a system that protects the status quo against new market entrants, both foreign and Japanese. The United States has aggressively pushed for the elimination of regulations that impede market access for U.S. firms, and many recent U.S.-Japan trade agreements have addressed issues related to the regulation of Japan's markets.

The U.S.-Japan Enhanced Initiative on Deregulation and Competition Policy

To promote the goals of the Framework Agreement, accelerate the pace of deregulation in Japan, and increase market access for foreign goods and services, on June 19, 1997, President Clinton and then- Prime Minister Hashimoto established the Enhanced Initiative on Deregulation and Competition Policy ("Enhanced Initiative"). The Enhanced Initiative addresses sectoral issues, such as telecommunications, housing, medical devices and pharmaceutical products, financial services, and energy; and cross-cutting structural issues, including competition policy, legal services, distribution, and transparency and other government practices. Under the Initiative, the United States has sought the reform of government laws, regulations, administrative guidance and other measures that impede market access for foreign goods and services in Japan.

During 1999, the second year of the Enhanced Initiative, significant progress was made in eliminating a number of Japan's regulatory barriers. In the Second Joint Status Report issued in May 1999, Japan agreed to a number of important deregulation measures, including decisions to:

< Liberalize the use of flexible telecommunications network arrangements, thus allowing businesses to build out their networks more rapidly and efficiently;

< Recognize the value of innovation and the role of the market to facilitate the introduction of innovative pharmaceuticals into Japan, and develop streamlined and transparent procedures for the prompt creation of new reimbursement categories for new medical devices;

< Enact several financial services-related measures under the "Big Bang" initiative, including the adoption of disclosure standards for non-performing loans similar to those in the United States, the introduction of new investment trust products, and the improvement of fair trading rules in the Securities and Exchange Law;

< Amend its Electric Utility Industry Law to shift from a permit and approval

system to a notification system for construction or upgrading of all power generating facilities;

< Accelerate the introduction of performance-based standards for three-story, multi-family wood housing in urban residential areas from JFY 2000 to May 1, 1999;

< Closely monitor local government implementation of the new Large-Scale Retail Store Location Law to ensure that the Law is not abused or administered inconsistently;

< Further strengthen its investigatory powers with regard to anti-cartel enforcement; and

< Adopt and implement public comment procedures for formulating, amending, or repealing Japanese Government regulations.

In October 1999, the United States provided Japan its "Submission by the Government of the United States to the Government of Japan regarding Deregulation, Competition Policy, and Transparency and other Government Practices in Japan." This submission detailed the deregulation measures the United States is seeking in each of the sectoral and structural areas during the third year of the Enhanced Initiative. U.S. officials urged Japan to adopt these measures at working-level meetings held throughout 1999-2000. In February 2000, the Deputy U.S. Trade Representative and Japan's Deputy Foreign Minister chaired a senior-level meeting to discuss the status of action on these requests and to narrow differences on outstanding issues. Both Governments agreed to aim to issue a Third Joint Status Report by March 31, 2000 that specifies substantive new market-opening measures to further deregulate Japan's economy.

SECTORAL DEREGULATION

Telecommunications

Under the Enhanced Initiative, the United States is seeking regulatory changes to promote competition in Japan's telecommunications sector, allowing U.S., foreign, and Japanese domestic carriers to enter and compete successfully against incumbent Japanese carriers. This sector has long been encumbered by excessive, outdated regulations and controlled by a dominant carrier, Nippon Telegraph and Telephone Corporation (NTT), that exercises market power to deter the entry and development of new competitors. These problems are compounded by the fact that the Ministry of Post and Telecommunications (MPT), which regulates the telecommunications sector, has no firm legal mandate to promote competition, and its many other missions, including promoting local industry and technological development, often conflict with its stated desire to promote a more competitive telecommunications sector. This has led to regulatory decisions that undercut or slow the development of competition in Japan. Japan's telecommunications regulatory framework focuses on whether carriers own or lease lines, not whether they have dominance in the market. This latter approach, called dominant carrier regulation, has been adopted by regulators in the United States and most other competitive markets because it puts competition first in setting policy. Under this approach, regulators promote competition by focusing regulatory oversight on "dominant carriers" – carriers in a position to hold consumers and competitors "hostage" through control over services or underlying facilities – while allowing carriers without such market power to operate with minimal restraint to speed the introduction of new services and technologies.

The United States is strongly urging Japan to adopt a legal framework that establishes the promotion of competition for the benefit of consumers as the clear primary objective of telecommunications regulation and make dominant carrier regulation the key component

of this system. The United States has focused particular attention on those areas where U.S. firms have demonstrated strengths and where existing and potential investments stand to bring much-needed growth to this sector through innovative, competitively priced services. Since the Japanese telecommunications and broadcasting services market is worth an estimated $130 billion per year (and has the potential to expand significantly), a more open and accessible Japanese telecommunications market will translate into significant increased opportunities for U.S. service and equipment exporters.

As highlighted in the First and Second Joint Status Reports, Japan has made some progress in addressing certain areas of concern to the United States. Notably, Japan agreed to: (1) introduce a pro-competitive methodology for setting interconnection rates in 2000; (2) promote the reduction of interim interconnection rates, including ensuring that the relationship between retail and interconnection rates does not impair local competition; (3) take steps to ensure that interconnection rates for the dominant wireless carrier (NTT DoCoMo) are cost-oriented and non-discriminatory; (4) increase the flexibility given to carriers to structure and manage their networks; (5) eliminate foreign investment restrictions in cable TV businesses; (6) enact regulatory changes necessary for the introduction of new broadband technologies, such as Digital Subscriber Lines (DSL); (7) allow direct-to-home satellite service providers to offer a significantly expanded number of channels; (8) liberalize rules to allow international telecommunications service providers to use leased lines to bypass the over-priced international settlement system and bring international rates in line with those of competitive markets; (9) eliminate the restrictions on foreign investment in its major international carrier, *Kokusai Denshin Denwa* (KDD); (10) remove the restrictions on using third parties for transit of international telecommunications traffic; (11) complete a study on rights-of-way with the aim of improving access to these scarce resources; and (12) reduce fees and simplify procedures for testing and certifying wireless equipment.

These actions and commitments, which the United States continues to monitor closely, should help address important market access and regulatory barriers. Nevertheless, ensuring effective competition, especially in the local telecommunications markets, will require Japan to demonstrate that it can allow for the operation of an independent regulator more attuned to providing equitable opportunities to new entrants and less biased towards the financial interests of an operator still majority-owned by the Government of Japan.

In its October 1999 deregulation submission, the United States urged Japan to undertake a "Telecommunications Big Bang" in order to fundamentally alter its telecommunications regulatory structure and promote competition in the Japanese market. This would entail the adoption of a system of dominant carrier regulation that would free new entrants from regulatory burdens while safeguarding against anti-competitive practices by dominant carriers. In support of this policy change, the United States has specifically asked Japan to address market access impediments related to a wide range of areas:

Interconnection and Pricing: One of the most significant examples of insufficient safeguards on dominant carriers impeding competition is the high cost and onerous conditions that NTT regional operators are allowed to impose on their competitors. For a typical call, the interconnection rates that these operators charge their competitors to use their network are currently over four to ten times as high as similar rates in the United States, quadruple rates in the U.K., and over two-and-a-half times those of Sweden and France. This occurs because NTT has been allowed to pass along its inefficiencies to its competitors. In addition, MPT has permitted NTT to recover bloated costs for developing and introducing new services such as ISDN by charging these costs to competitors while it subsidizes this service for its retail customers. This classic "price squeeze"

behavior – forcing its competitors to lose money if they are to price a competing service at or below NTT's retail rates – ensures that NTT maintains its hold on the market. This also highlights the inherent contradiction of Japan's regulatory regime in that MPT is simultaneously engaged in industrial policy – promotion of ISDN and fiber-to-the-home – while trying to regulate a dominant carrier.

This type of behavior has had a major impact on local competitors, which lose money on many local services and often pay around 70 percent of the revenues they receive from all calls back to NTT in interconnection charges. Compounding this problem, MPT has also allowed NTT regional companies to adopt discriminatory pricing schemes that leverage their virtual monopolies (98 percent of all local subscribers) to ensure that traffic stays on NTT's network. Under these pricing schemes, NTT regional company subscribers cannot get discounts on calls to numbers on competitors' local networks, even if they are in the same area. As most of these discount plans are used for Internet access, they effectively force Internet Service Providers (ISPs) to locate on NTT's network if they want to service NTT's huge customer base. This denies competitors the ability to host ISPs on their own network, a lucrative business, and forces competitors to pay substantial interconnection fees when their subscribers access ISPs on NTT's network. Under these circumstances, not only do competitors lose the ability to host ISPs, but they also are unable to match NTT's flat rate user rates for dial-up Internet services because of the interconnection fees they must pay NTT. Given the growing importance of Internet services in Japan's telecommunications market and the predominance of dial-up services for Internet access for the foreseeable future (see "Electronic Commerce" section of this chapter), MPT's failure to take action against NTT regional companies' pricing schemes will significantly hurt the development of both telecommunications competition and ISPs.

To achieve interconnection rates that promote rather than hinder competition, the United States has strongly requested that Japan adopt a pro-competitive methodology for interconnection fees, known as Long Run Incremental Costing (LRIC). This methodology is being used by regulators of competitive markets throughout North America, Europe and Asia. In the May 1998 First Joint Status Report of the Enhanced Initiative, Japan agreed to implement LRIC in 2000.

The United States has also sought significant reductions in Japan's interconnection rates before LRIC is implemented. Despite assurances by MPT that it would make best efforts to reduce these interim interconnection rates, we remain concerned that the decreases have been minimal. For example, interconnection rates for local switching fell only around six percent for JFY 1998, and the proposal for JFY 1999 envisions only a four percent decline.

New entrants to Japan's telecommunications market have expressed concern about the extremely high and non-transparent interconnection and access rates charged by dominant wireless service provider NTT DoCoMo as well. There is no explanation of how these exorbitant rates are calculated. In addition, DoCoMo has used its market power (servicing over 25 million subscribers) to insist that it be allowed to set prices for both incoming and outgoing calls for its network. This puts new entrants at a severe disadvantage as they are unable to compete on price – one of their most important strategies. As a result, they usually end up paying DoCoMo a much greater per-minute charge for passing calls to DoCoMo than DoCoMo pays them when it passes calls to the new entrants. While MPT promised in April 1999 to ensure that DoCoMo's interconnection rates are cost-oriented and non-discriminatory, the situation has not improved significantly. The United States has asked MPT to take measures to increase the transparency of DoCoMo's interconnection regime, require DoCoMo to allow other carriers to set retail rates, and impose the more stringent interconnection conditions of a "designated carrier" on DoCoMo.

Rights-of-way: New competitors in Japan find it extremely time-consuming and expensive to build competing networks in Japan because of a lack of access to rights-of-way. Specifically, there are no safeguards against NTT and other utilities (with substantial investments in telecommunications firms) denying or delaying access to, or charging exorbitant rates for the use of, their poles, ducts, conduits and other "rights-of-way" facilities. New carriers thus find it extremely difficult, time-consuming, and expensive to obtain rights to use these facilities. Moreover, if new entrants attempt to dig roads to lay their own cables and facilities, they encounter a labyrinth of restrictions that industry sources say makes the construction about ten times more expensive and can result in digging times six times longer than in other major international cities. The United States has proposed that Japan establish pro-competitive rules to ensure non-discriminatory, transparent, timely, and cost-based access for telecommunications carriers and cable TV operators. The Government of Japan set up a study group to address this problem at the request of the United States. However, its recommendation – voluntarily publishing by NTT and electric utilities that control rights-of-way of their application procedures to increase transparency – falls far short of the type of measures that are necessary to promote competition. The United States continues to urge a fundamental decision to require access for new competitors.

Unbundling: Enhanced government oversight to assist new entrants in building their networks also is needed to mandate that the dominant local carrier provide access to elements of the network that other carriers require on an "unbundled" (or separate) basis. Currently, Japan's interconnection guidelines contain only a narrow list of functions that must be "unbundled" for new competitors, and do not require that these unbundled elements be priced in a pro-competitive manner. The United States has requested that Japan expand the list of elements that must be unbundled by a dominant carrier and ensure that new and existing elements are provided on rates, terms, and conditions that are timely, reasonable and non-discriminatory. This mandatory unbundling, to which we are committed in the U.S. market, will greatly assist new carriers in building their networks.

Leased lines: New entrants are constrained from developing competing networks as a result of MPT's refusal to allow new entrants to lease lines from other carriers. While MPT provides several means for these new carriers to use other carriers' facilities, they are required to apply for MPT approval of these arrangements. This adds extra time and expense for new carriers and increases uncertainty in business planning because many of the criteria MPT uses to determine the approval of these requests are non-transparent. The United States has requested that MPT eliminate current restrictions and allow carriers to freely combine owned and leased facilities in their network without the need for government approval.

Other barriers: The United States also has asked Japan to address the complaints of new entrants regarding the difficulty and expense of getting access to space in NTT's buildings needed to interconnect with NTT's network (co-location space), and access to internal wiring in private buildings throughout Japan. Finally, in response to NTT's restructuring into four companies as of July 1, 1999, the United States has urged Japan to strengthen its safeguards against anti-competitive cross-subsidization by the NTT successor companies.

Because several of these issues, notably interconnection costing, discriminatory pricing, unbundling, and the use of leased capacity, relate to Japan's WTO commitments, Japan's efforts to address these areas will come under heavy scrutiny.

Medical Devices and Pharmaceutical Products

Under the 1986 Market-Oriented, Sector-Selective (MOSS) Medical Device and Pharmaceutical agreement, the United States and Japan seek to address regulatory and market

access concerns in the medical device and pharmaceutical sectors. The MOSS Med/Pharm working group now also serves as the venue for discussion of medical device and pharmaceutical issues under the Enhanced Initiative, including price reimbursement and regulatory issues which remain the focus of bilateral consultations. The United States and Japan held consultations on Japanese deregulation of medical devices and pharmaceutical products in September 1999 and in January and March 2000 to review implementation of Japan's undertakings under the Enhanced Initiative, and to agree on additional measures designed to improve Japan's regulatory and reimbursement structures.

Despite some improvements, Japan's approval process for medical devices and pharmaceuticals still lag behind those of other industrialized countries. Such delays impose unnecessary cost burdens on both U.S. manufacturers and the Japanese health care system. Under the Enhanced Initiative, Japan has agreed to expedite its regulatory approval for new drugs by reducing the application review process from 18 months to 12 months by April 2000. This welcome change will allow more rapid introduction of new medicines into Japan, a benefit to both Japanese consumers and U.S. manufacturers alike. Japan already has taken steps to implement this undertaking, including reforming its chief advisory council for regulatory approvals, the Central Pharmaceutical Council, to allow for more frequent meetings and direct communication between reviewers and applicants. The United States continues to closely monitor Japan's implementation of this policy and is urging Japan to take specific added measures to improve the new drug application approval process.

As product cycles for medical devices are relatively short, even small delays represent large potential losses to manufacturers. The United States is pursuing improvements in the medical device approval system with particular emphasis on reducing the redundancies between different regulatory bodies in Japan. The United States is encouraged by the plans of the Ministry of Health and Welfare (MHW) to improve the consistency and speed of this process and to clarify the scope of devices that do not require clinical trials, and will closely monitor developments and request further progress. The United States also is urging Japan to reform its biocompatibility testing regime to more closely conform with common international practices.

Japan's longstanding practice of limiting the acceptance of foreign clinical data for pharmaceutical and medical device approvals has imposed unnecessary and unwarranted time and resource burdens on U.S. firms by requiring them to conduct duplicative clinical trials in Japan. Under the Enhanced Initiative, Japan has agreed to greatly expand the acceptance of foreign clinical data in the approval of new medical devices and pharmaceuticals – a measure which will significantly reduce the time and expense U.S. firms must devote to new product testing and approval. The United States welcomes Japan's undertaking to accept all foreign clinical data that meet International Conference on Harmonization (ICH) and Japanese Good Clinical Practice Guidelines and is monitoring its implementation closely while urging Japan to only require additional domestic clinical tests only when there is a clear need under the ICH Guidelines. The United States also is pursuing additional steps designed to broaden Japan's acceptance of foreign clinical data in the reimbursement process for medical devices in order to prevent delays caused by demands for domestic data.

In addition to regulatory barriers, the United States is seeking to address specific market access issues associated with Japan's current reimbursement system and its longstanding practice of revising prices for medical devices and pharmaceuticals. The United States continues to urge Japan to ensure that its reimbursement system is transparent, free from conflicts of interest, and based on objective criteria. Under Japan's national health care insurance system, reimbursement prices for drugs and devices do not always appropriately reward the true benefits of innovative products. The goal of the United States is to promote objectivity and transparency, to ensure that

pricing decisions are not made in a seemingly arbitrary manner.

Most U.S. manufactured medical devices on the Japanese market fall under the "by-function" pricing system, which assigns a newly introduced product to a reimbursement category of like products, and prices the new product based on the prices of other products already on the market. The United States is particularly concerned about Japan's plans to reform this system. If implemented as currently drafted, the Japanese restructuring plan for pacemakers, PTCA catheters, and orthopedic implants, which are largely supplied by U.S. manufacturers, would price higher-end products together with lower-end products. By pricing new products equally with older ones, the system would fail to recognize innovation, and has the potential to impede or prevent the introduction of innovative medical devices in Japan. The plan also would result in an additional price reduction this year for many of these newest, most innovative products above and beyond the regularly scheduled biannual price revision. Moreover, Japan's moves toward adopting too few a number of broad "by-function" categories could make it very difficult to justify the creation of new categories. The United States is strongly urging Japan to take steps to prevent such negative outcomes.

In formulating its health care reforms, Japan has agreed to formally recognize the value of innovation so as not to impede or prevent the introduction of innovative products that bring more effective and more cost-effective treatments to patients. As Japan discusses, develops, and implements pharmaceutical reform, including the treatment of innovative products, with the aim of finalizing measures by April 1, 2002, the United States is urging Japan to continue to discuss and study the pharmaceutical pricing system with related parties, including the U.S. industry, with the goals of promoting innovation and increasing the availability of innovative pharmaceutical products.

Lack of transparency in and access to decision-making processes have been longstanding problems in the medical device and pharmaceutical sectors. Under the Enhanced Initiative, Japan agreed to ensure transparency in the consideration of health care policies by allowing foreign pharmaceutical and medical device manufacturers meaningful opportunities to provide their opinions to the relevant councils on an equal basis with Japanese manufacturers. Japan also agreed to provide foreign pharmaceutical and medical device manufacturers, upon their request, with opportunities to exchange views with MHW officials at all levels – an undertaking that to date has been successfully implemented. The United States is encouraging Japan to carefully consider input provided by U.S. industry, as well as to incorporate such input into its final plans.

Finally, the United States is strongly urging Japan to address the structural problems underlying Japan's health care system, such as the lack of volume buying and inadequate hospital specialization, which prevent efficient care delivery, substantially increase costs, and impede the timely introduction of new, innovative, and life-saving medical devices and pharmaceuticals. The United States continues to stress that cutting costs and improving the health care system in Japan will require the elimination of inefficiencies as well as the increased accessibility and use of foreign medical and pharmaceutical products. This will result in significant benefits to Japan's health care system and to Japanese patients.

Housing

The housing experts group established under the Enhanced Initiative met in February and December of 1999 and February 2000. The group promotes improved market access in Japan for foreign suppliers of wood and non-wood building products and systems. Achievement of this objective and increased reliance on performance-based standards by Japan will increase opportunities for American exporters and encourage the construction of

higher quality, safer, and more affordable housing in Japan.

U.S. efforts on this front have led to several significant changes. For example, under the Second Joint Status Report, Japan's adoption of public comment procedures will make it easier for U.S. building materials suppliers to participate in the formulation and implementation of revisions to Japan's Building Standard Law, the cornerstone of Japan's national housing policy. Japan also agreed to implement performance-based standards for three-story, multi-family wood housing, and to participate with the U.S. Government in a series of jointly sponsored seminars that will help build the market for U.S.-style building materials and methods.

In the October 1999 deregulation submission to Japan, U.S. housing proposals focused on laws, policies, and procedures that inhibit the development of quality rental housing and resale and renovation markets. Reform of these structural weaknesses would significantly broaden the Japanese housing market and create new commercial opportunities for U.S. suppliers. For example, the United States proposed that Japan overhaul its rental laws to provide landlords with a financial incentive to maintain and improve their properties. Japan responded by amending its Land and Housing Lease Law, eliminating automatic lease renewals and limiting tenant rights to resist eviction or rent increases. These reforms, which took effect on March 1, 2000, should enable Japan to develop a quality housing rental market for the first time, improving housing options for Japanese families and creating enormous opportunities for domestic and foreign builders and suppliers.

As a proportion of its overall housing market, Japan's home resale market is far smaller than that of the United States. The lack of an adequate property appraisal system artificially limits the Japanese housing market by reducing circulation of existing homes. Japan's overemphasis on the chronological age of housing discourages both renovation and resale of the existing housing stock leading Japanese consumers to see renovation as a consumption expenditure rather than an investment in long-term housing value. The United States has proposed that Japan reform its housing appraisal system so that maintenance and renovation are factored into value assessments. The United States also has urged the Japanese Government's Housing Loan Corporation to bring the length of its mortgage terms for high-quality resale housing more closely into line with those offered for new houses.

Moreover, the United States has proposed deregulation of some specific product areas, such as food waste disposers and interior finish products, so that Japanese consumers may finally enjoy functional features in their homes that are commonplace in other highly developed countries. These systems are standard equipment in American homes, and are increasingly common in Europe as well, but are entirely absent in Japan. Use of food waste disposers would help Japan in a number of ways, helping to lower dioxin emissions by curtailing incineration to burn food waste; energy use because incineration is not energy-efficient; the pressure on Japan to find more space for landfills; and the need to devote resources to upgrading incineration plants.

The Ministry of Construction (MOC) claims it has no authority over the connection of these disposers to local sewage lines. However, Ministry officials admitted to U.S. trade negotiators in December 1999 that they urged local authorities to "use caution" in allowing the use of disposers. In addition, many cities and some prefectural governments ban the sale of disposers. At a meeting on March 1, 2000, U.S. industry representatives provided Japan with a number of recent studies documenting the efficacy and environmental friendliness of disposers. The United States will continue to pursue this issue with Japan.

Finally, the United States has advocated additional liberalization in the forest products sector, such as implementation of performance-based building standards for certain four-story

wood-frame buildings. Such action could strengthen the current boom in wood-frame housing construction made possible by Japan's liberalization of restrictions against three-story wood-frame buildings in 1999, creating further opportunities for the U.S. forest products industry.

Financial Services

Japanese financial markets traditionally have been both highly segmented and strictly regulated, and as such, have discouraged the introduction of innovative products where foreign firms may enjoy a competitive advantage and otherwise restricted business opportunities for foreign firms. Some of the restrictions that have impeded access include the use of administrative guidance, existence of a *keiretsu* system (interlocking business relationships), lack of transparency, inadequate disclosure, the use of a positive list to define a security, and lengthy processing of applications for new products. Each of these restrictions has hindered the emergence of a fully competitive market for financial services in Japan.

In an effort to eliminate or reduce these barriers, in February 1995, the United States and Japan concluded a comprehensive financial services agreement, "Measures by the Government of Japan and the Government of the United States Regarding Financial Services." This agreement features an extensive package of market-opening actions in the key areas of asset management, corporate securities, and cross-border financial transactions. In the five years since the agreement was signed, Japan has implemented the specific commitments made within the specified time frames. In some instances, the timetable for implementation was accelerated. In a few areas, Japan has taken or announced additional actions for future implementation to improve the liberalization of Japanese financial markets.

Building on the progress from the 1995 agreement, in November 1996, then-Prime Minister Ryutaro Hashimoto announced the "Big Bang" initiative to carry out broad-based deregulation of Japan's financial sector in order to make Tokyo's financial markets comparable to those of New York and London by 2001. This financial reform plan involves major changes, such as allowing broader mutual entry across financial sectors; liberalization of brokerage commissions and foreign exchange transactions; tightened disclosure rules; and further liberalization of asset management regulations. These major changes could create important new business opportunities for U.S. financial services providers. Despite increased concern in Japan about financial sector stability in late 1997 following several prominent financial bankruptcies, the Government of Japan has thus far adhered to its reform schedule, with a few exceptions.

In May 1999, legal restrictions on nonbank financial institutions' use of bond proceeds to fund credit operations were removed. In October, the liberalization of stock brokerage commissions was completed, and restrictions on cross-entry between banking and securities were eliminated, while restrictions on cross-entry among banking, securities, and insurance were eased. Legislation passed in 1999 granted tax-exemptions to non-residents and foreign corporate holders of Japanese government bonds within the Bank of Japan book-entry trading system, and the securities transaction tax and bourse tax were abolished. Japan's accounting practices also continued to improve in 1999 with the introduction of new standards, as of April 1, that include: consolidated accounting procedures; market-to-market accounting for corporate pension assets; and fair-value accounting for marketable financial assets for trading purposes.

The past few years have seen notable changes in Japan's financial sector. Supervision and disclosure have improved. Foreign financial institutions have made important acquisitions in securities brokerage and insurance, and negotiations concluded in February 2000 finalizing the sale of a major nationalized bank to a foreign investment group. Consolidation among Japanese financial institutions has increased in an effort to cut costs and boost

competitiveness, while traditional segmentation among various types of financial institutions is gradually being phased out. These changes have expanded opportunities for foreign financial firms in Japan to compete on a clear and level playing field. While supervision and disclosure have improved, it is important that Japan continue to move forward in establishing clear and consistent regulation and supervision of financial institutions, in line with international standards and best practice.

The United States continues to monitor implementation of the agreement and to assess the impact of the actions undertaken using the quantitative and qualitative criteria included in the agreement. At the December 1999 review, the United States emphasized the need for Japan to move forward in establishing clear and consistent regulation and supervision of financial institutions in line with international standards and best practices. The United States also is monitoring Japan's progress under the "Big Bang" initiative to ensure that implementation remains on schedule. In December 1997, Japan also signed the WTO Financial Services Agreement – which entered into force on March 1, 1999 – thereby binding itself to many of the liberalization measures of the bilateral agreement.

Energy

The United States and Japan agreed to establish a working group on energy under the Enhanced Initiative in May 1998. The United States views these discussions as a means of providing input to Japan as it deregulates this key sector, and as a way of supporting the Government of Japan's goal of lowering energy costs – which are among the highest in the world – to internationally comparable levels by 2001. The achievement of Japan's goals largely depend on its ability to attract new entrants into its electricity market – the third largest power market in the world – and to create vigorous competition in this sector.

Throughout 1998, a committee of the Electric Utilities Industry Council (EUIC) – a private sector advisory group to the Agency for Natural Resources and Energy (ANRE), and the Ministry of International Trade and Industry (MITI), its parent ministry – developed plans to liberalize the Japanese power market. The committee's final report in December 1998 called for "partial liberalization" of the power market, with retail sale of electricity to be liberalized for large-scale users served by extra-high voltage networks (of 20,000 volts or higher), which account for approximately 27 percent of total electricity consumption in Japan. While welcoming the liberalization of the electricity sector, the U.S. Government expressed its view that the EUIC proposals would make only modest progress towards Japan's goal of achieving significantly lower energy costs.

During the first year of the energy working group, the United States presented proposals for addressing specific regulations that impede the sale of U.S. equipment and services in the Japanese energy sector, including: (1) regulations for approval and inspection of energy-related equipment under the Electric Utilities Industry Law and High Pressure Gas Law; (2) regulations for increasing the capacity of existing power generating facilities; (3) requirements for certification and approval of stand-by generator sets; and (4) regulations governing the manufacture and installation of self-service gasoline pumps.

The United States urged Japan to: streamline these regulations and certifications procedures; accelerate its efforts to adopt performance-based regulations through greater utilization of voluntary, private-sector standards, where appropriate; accept internationally recognized test data and certifications; and take additional steps to enhance the transparency of its rulemaking and standards development processes. Japan agreed to take concrete steps to address many of the U.S. concerns regarding standards, inspection and certification requirements, and other regulations covering the import of specific types of energy-related equipment, including turbines, compressors, gasoline pumps, and stand-by generator sets.

Japan also agreed to liberalize regulations governing the expansion of existing power generation facilities. The United States is monitoring Japan's implementation of these measures, which will help encourage new entrants and additional investment in the Japanese energy sector and support Japan's efforts to lower energy prices.

In the third year of the Enhanced Initiative, the United States urged Japan to take specific steps critical to the successful transition from a monopoly to a competitive market in the electricity sector. These include: (1) reducing regulatory and other barriers that discourage investment and market entry; (2) implementing appropriate incentives and disciplines for pro-competitive behavior; and (3) providing for full transparency in setting and implementing rules and procedures so that appropriate and fair rules are set and rational business decisions can be made. The United States and Japan discussed these proposals in detail during working group meetings in November 1999, and in January and February 2000. The United States noted that worldwide experience shows unbundling previously vertically-integrated power utilities' operations (as proposed by former MITI Minister Sato when he launched Japan's energy deregulation initiative) into separate generation, transmission, and distribution operations is generally viewed as necessary to encourage competition and achieve significant efficiency gains. The United States also urged Japan to establish sufficient oversight to ensure open and fair access to the transmission system and to ensure full access to information relating to the newly deregulated market, and rates, terms and conditions of access to transmission. The United States provided additional detail on these issues in written public comments submitted to Japan on its various draft reports, regulations, and guidelines.

Japan will implement its partial liberalization of the electricity sector on March 21, 2000 and plans to abolish its antimonopoly exemption of natural monopolies, including electricity and gas, in 2000. The United States will continue to closely follow developments in this sector and to strongly urge Japan to take additional steps to ensure open and fair access to the market.

Natural gas: In May 1999, the Diet passed a law deregulating Japan's natural gas sector, although this sector is not expected to be deregulated until early 2001. MITI and the JFTC have recently drafted proposed fair transactions guidelines on gas trade, on which the United States provided public comments. Later in 2000, study groups will consider how transmission charges for the use of natural gas pipelines should be determined with the aim of having such charges in place by early in 2001. At energy working group meetings in 1999-2000, the United States raised its concerns that gas deregulation has a significant impact on electricity deregulation since new entrant electric power producers are likely to use natural gas as a fuel. In such cases, gas transmission charges, as well as terms and conditions of access to pipelines and to Liquefied Natural Gas Terminals through which all of Japan's gas flows, will be critical.

STRUCTURAL DEREGULATION

Antimonopoly Law and Competition Policy

Under the Enhanced Initiative, the United States has proposed a number of progressive measures in order to strengthen competition policy and generate more effective enforcement of Japan's Antimonopoly Law (AML). The United States believes that further strengthening of AML enforcement and competition policy in Japan is critical to improving market access. Foreign companies continue to face numerous impediments to accessing Japan's distribution channels across a wide range of sectors, including the automotive, flat glass, and photographic film and paper markets. Since October 1999, the United States has focused particular attention on achieving genuine progress in the following AML and competition policy-related issues under the Enhanced Initiative.

Independence of the JFTC: An independent JFTC has been a longstanding and important

principle of Japan's antimonopoly enforcement system that the United States strongly believes should be maintained. In this regard, the United States has urged Japan to take additional measures that will ensure the continued independence of the JFTC when it is transferred from an agency within the Prime Minister's Office, to one under the future Ministry of General Affairs (MGA) in 2001 as part of the central government's reorganization. In particular, the future MGA will also be responsible for telecommunications policy, raising the real risk that the JFTC will not be able to act independently in the crucial area of telecommunications, both in enforcement decisions and competition advocacy. The United States has recommended that a Cabinet order be issued to ensure that MPT and MGA will not intervene in the JFTC's application of the AML in the telecommunications area, and that the integrity of the JFTC's personnel system and budget will also be maintained.

Anticartel Enforcement: Bid-rigging and collusive cartel activity continue to be serious problems in Japan. In its October 1999 deregulation submission, the United States has called for more aggressive enforcement actions to combat these activities and has urged Japan to enhance the investigatory burden sharing between the JFTC, the Ministry of Justice, and other relevant government agencies. In addition, the United States has proposed that an advisory council be established to examine methods of strengthening the JFTC's criminal investigation and accusation powers, stronger sanctions for obstructing investigations, and reform of the administrative surcharge system. To better combat bid-rigging, the United States recommended a new initiative to increase National Police Agency and prefectural police department investigations of criminal bid-rigging; enhanced cooperation between the JFTC and other law enforcement agencies charged with investigating potential illegal bid-rigging activities; stiffened punishment of complementary bidders and recoupment from bid-riggers of all overcharges; and other measures to reduce the opportunities for successful bid-rigging activities.

Private Remedies: Under current Japanese law, injured parties lack the right to bring a private injunction action against an alleged violator of the AML. Regarding private actions for monetary damages, since 1947 only 11 private actions for damages have been brought under the AML. This is due, in part, to the fact that the JFTC must first issue a final decision against a firm before a private party can bring a damage action against the same firm. The United States strongly believes that the unfettered availability of injunctive relief and monetary damages to private litigants is an integral part of a comprehensive antimonopoly legal regime. In short, persons directly injured by anti-competitive behavior should be able to seek remedies if they choose to do so.

Moreover, private AML enforcement can help reinforce to Japanese firms the importance of conforming their business practices to the AML, which in turn will keep markets free, open and competitive. A study group established by MITI issued a report in June 1998 that guardedly favored allowing private parties to bring injunction actions. A JFTC advisory council also studying the question of private injunctive relief, as well as reform of the current system of private damage actions issued its final report in October 1999, and in December 1999, the JFTC announced that draft legislation would be submitted to the ordinary Diet session early in 2000. While the United States welcomes this initiative, it is unclear whether the legislation covers injunctions against the most serious of AML violations – monopolization and agreements among competitors to restrain trade. Moreover, the council reached few conclusions on easing impediments to damage actions. The United States therefore strongly urges Japan to enact legislation that will comprehensively address the current limitations on private injunctive relief and action damages.

Promotion of Deregulation by the JFTC: Successful regulatory reform in Japan must be built on a solid foundation of effective competition policy. As the only Japanese agency charged with promoting competition, the JFTC should substantially boost its efforts as an

advocate of competition policy and regulatory reform. The United States requested that the JFTC strengthen its monitoring of private sector regulations (*min-min kisei*) that may be used by industry and trade associations to restrict competition or market entry. The United States also proposed that the JFTC actively participate in the process of deregulating Japan's public utilities, both to ensure that maximum deregulation occurs in the electricity and natural gas sectors consistent with sound competition policy, and that anti-competitive conduct by incumbent utilities will be strictly dealt with under the AML. Moreover, the United States recommended that the JFTC take further steps to promote a competitive and efficient distribution sector, for example, by surveying manufacturer-distributor equity and personnel relationships in highly oligopolistic sectors; monitoring closely the process of reviewing plans of retailers to establish large-scale stores; and promoting further AML compliance programs.

Antimonopoly Law Exemptions: In its October 1999 deregulation submission, the United States recommended that Japan repeal the AML §21 exemption for natural monopolies, including gas, electricity, and railroad businesses, electricity and gas, by April 2000. The JFTC has announced that it will submit legislation to eliminate in early 2000 Article 21 of the AML. The United States has sought the removal of this exemption for many years, and will welcome early and full Diet action on the proposed legislation.

Industrial Revitalization Law: Implemented in October 1999, Japan's Industrial Revitalization Law superseded the Business Reform Law which, among other things, authorized Cabinet ministers to consult with the JFTC when firms in industries under their supervision jointly submitted business reform proposals. By deviating from the normal practice of the JFTC's review of joint conduct under the AML, this consultative mechanism inappropriately diminished the independence of the JFTC and could have been construed as an AML exemption.

The United States long opposed this aspect of the Business Reform Law, noting that Japan had the opportunity to completely resolve concerns regarding its effect on the JFTC's independence when the Industrial Revitalization Law was enacted. While the most troubling language of the old law was dropped, the Industrial Revitalization Law nevertheless incorporates the concept that when restructuring firms jointly apply for benefits under the Law, the Minister supervising that industry will be the final arbiter of those applications, and is vague regarding the relationship of that Minister to the JFTC's review. In its October 1999 deregulation submission, the United States urged Japan to affirm that the Law in no way supersedes the AML or prejudices the JFTC's independence in enforcing the AML; ensure that the JFTC is notified of, and has the chance to review, all applications, especially joint applications, submitted under the Law; and make all JFTC advice regarding such applications publicly available in so far as possible.

JFTC Staffing & Resources: The JFTC's ability to enforce Japan's AML is hindered by its historically weak stature among Japanese ministries, shortage of personnel, and inadequate investigatory powers. The United States has urged for more than a decade that the JFTC's budget and staff be increased significantly to ensure that it is able to carry out its mandate fully.

In JFY 1999, JFTC staff increased by only nine members from the previous year to a total of 558, of which 260 (seven more than in JFY 1998) are engaged in investigation-related work. There are 63 investigators (an increase of three) in the special investigations department. The United States recommended that the JFTC staff be increased by an extraordinary amount in JFY 2000, or by at least 50 persons. Subsequently, the JFTC, seeking to take advantage of the opportunity created by the government's imminent reorganization, requested an increase in staff of 45 persons. Unfortunately, Japan's draft JFY 2000 budget increases the JFTC's budget by only 2.1 percent and boosts its personnel by only 11, of which eight will be

assigned to the investigation bureau. These increases remain too small for the JFTC to adequately enforce competition laws and policies. This is especially true given the potential effects on Japan's competitive environment caused recently by the increase in mergers (up 24.9 percent in 1999), the liberalization of holding companies, the narrowing or elimination of many AML exemptions, and stepped up deregulation that now require the JFTC to police more business behavior. The United States also urged Japan to support active application of AML to proposed mergers and acquisitions, including additional resources for JFTC review of merger plans and increased transparency of the JFTC's review process.

Distribution

Japan's highly regulated, inefficient distribution system is widely recognized as a significant trade and investment barrier. Through the Enhanced Initiative's working group on structural issues, the United States has focused on laws, regulations, and practices that contribute to the abnormally high costs of distribution in Japan, such as slow customs processing and excessive regulatory restrictions in the retail sector (see "Import Policies" section of this chapter). In its October 1999 deregulation submission, the United States urged Japan to implement significant deregulatory measures to address key distribution problems faced by foreign firms.

Regulation of Large-Scale Retail Stores: The Large-Scale Retail Store Law has long been an obstacle to foreign investors and exporters, with its limitations on the establishment, expansion and business operations of large stores in Japan, which are more likely than other retail outlets to handle imported products. By impeding the business operations of large stores, the Law reduced productivity in merchandise retailing by raising costs, discouraged new domestic capital investment, and diminished the selection and quality of goods and services to the detriment of Japanese consumers.

In May 1998, the Diet passed legislation to abolish the Large-Scale Retail Store Law and replace it with the Large-Scale Retail Store Location Law (LSRSLL) on June 1, 2000. The new Law provides that regulation of large stores will no longer be based on supply/demand considerations, but on the degree to which a large store opening or expansion affects the local environment, particularly traffic, noise, parking, and garbage removal. Under the Law, local jurisdictions are not permitted to impose more severe restrictions on new large stores than are allowed under the LSRSLL, nor are they allowed to restrict entry of new large stores on competitive grounds.

While the United States welcomed the abolition of the Large-Scale Retail Store Law, the manner in which the new LSRSLL is implemented will determine whether it affords greater market access for large stores. In June 1999, after soliciting public comments, MITI finalized the new LSRSLL Guideline that provides national standards related to noise, traffic, parking and garbage that must be considered by entities intending to establish or expand a large store. The Guideline also is to be used by local governments in presenting opinions and making recommendations to large stores. In October 1999, again after soliciting public comments, MITI issued a Ministerial Ordinance that clarified the type of information required of large retailers when opening a large store, public briefings to be held to explain store plans, and procedures to be used by large stores and local governments to publicize relevant proceedings.

In the Second Joint Status Report under the Enhanced Initiative, Japan committed to: (1) closely monitor local governments' implementation of the LSRSLL to ensure that the purpose of the Law is not impeded; (2) establish a contact point in MITI to receive and facilitate resolution of complaints regarding the implementation of the Law; and (3) take appropriate measures to facilitate the resolution of complaints regarding application of the Law.

Despite these positive developments, the United States shares the concern of many large retailers

in Japan over the possibility for abuse or inconsistent application of the new authority by local governments. To help facilitate smooth implementation of the new Law and increase transparency, the United States in its 1999 deregulation submission urged Japan to: (1) publish the name and address of the contact point within MITI that will receive and facilitate resolution of complaints from parties regarding application of the LSRSLL; (2) ensure that the office of the contact point is fully staffed by June 1, 2000 when the new Law goes into effect; (3) undertake a broad educational campaign to inform local government officials of the content of the Guideline and Ministerial Ordinance, their legal responsibilities and the limitations on their authority under the LSRSLL, and the role of the contact point; and (4) ensure that all necessary measures are taken to remove obstacles that may impede the opening or expansion of large stores or discourage retail investors from planning an orderly expansion of their business during the transition from the current law to the new "Location" Law.

Transparency and Other Government Practices

In recent years, Japan has taken steps toward the development of a more transparent and accountable regulatory system, including through the implementation of an Administrative Procedure Law, the adoption of a Public Comment Procedure and the enactment of an Information Disclosure Law. The United States welcomes these measures. However, it believes that additional steps are necessary to achieve the level of transparency and accountability recognized as essential in the 1999 OECD Review of Regulatory Reform in Japan. The OECD found that: "Lack of transparency in regulatory and administrative processes is a major weakness of Japan's domestic regulatory system. Non-transparency affects all potential market entrants and competitors, who must have adequate information on regulations so that they can base their decisions on accurate assessments of potential costs, risks, and market opportunities, but has disproportionate costs for foreign parties." The OECD concluded that: "Investment, market entry, and innovation should be promoted by increasing the transparency and accountability of regulation."

The United States has urged Japan to introduce a broad regulatory reform program designed to bring greater transparency and accountability to its regulatory system. The underlying premise of the reform program should be that ministries and agencies must justify to the public the rationale for adopting, changing, or continuing new or existing regulations. Regulations should be the exception and not the rule, meaning that regulations that are not directly linked to public policy interests should be abolished or not adopted. The public should be given an effective means of participating in the development and assessment of regulations. The program should encompass both public and private regulations. Foreign firms are disadvantaged by the lack of transparency and accountability in Japan's regulatory system. As a consequence, the United States has long pressed Japan to make its administrative procedures and practices more open and transparent. Under the Enhanced Initiative, the United States has raised specific concerns, including the following:

Introduction of a Rulemaking Process: Japan adopted, as an administrative measure, its first government-wide public comment process, effective April 1, 1999, which requires central government entities to give notice and invite public comments on draft regulations, including Cabinet Orders (*seirei*), ordinances of the Prime Minister's Office *(furei*), ministerial ordinances (*shorei*) and notifications (*kokuji*), and to administrative guidance issued to multiple persons. Despite this improvement in the transparency of the regulatory process, the United States is concerned that Japan's ministries and agencies often do not allow sufficient time for public comments and in most cases appear to have not given adequate consideration to the public comments received. In order to ensure that the procedures are implemented in a manner that facilitates the greatest possible public participation, the United

States urges Japan to: (1) incorporate the Public Comment Procedure into legislation; (2) conduct a thorough review of the first year of the Public Comment Procedure's implementation, including inviting the public to comment; (3) allow at a minimum a 30-day comment period, and a 60-day comment period to the extent possible; and (4) require all advisory councils (*shingikai*, *kenkyukai*, *benkyokai* and *kondankai*) to solicit public comments before they finalize reports and recommendations.

Regulatory Impact Analysis: In its review of Japan, the OECD observed that: "Regulatory analysis would help officials understand the consequences of their regulatory decisions, improve the transparency of regulation, and identify more flexible and cost-effective policy instruments, such as economic instruments. Such alternatives are not widely used in Japan." To enhance transparency in its policy-making and administrative management, the United States has urged Japan to introduce a government-wide Regulatory Impact Analysis (RIA) into its review of regulatory changes that will have a significant economic impact. As part of the RIA, the United States has called upon Japan to require its ministries and agencies to: (1) analyze the anticipated costs and benefits (both quantifiable and non-quantifiable) to the public of regulatory proposals and their primary alternatives, as well as an accounting of its impacts on key elements of society; (2) use the best available scientific, technical, and economic data when reviewing proposed regulations; and (3) provide an opportunity for the public to comment on the cost/benefit analyses, as well as on the reasonableness of the assumptions and methodologies used, before the final regulatory changes are made.

Information Disclosure Law: In May 1999, Japan passed an Information Disclosure Law that will for the first time allow any individual or company – domestic or foreign – to request the disclosure of information held by central government ministries and agencies. The new Law becomes effective in 2001. Local governments have long had information disclosure ordinances. Despite urging by the United States, the new Law does not apply to special public corporations (*tokushu hojin*). However, in July 1999, the Government of Japan established an Investigation Committee on Access to Information Held by Public Corporations under the Administrative Reform Promotion Headquarters to study and make recommendations with regard to legislation that will require the disclosure to the public of information by *tokushu hojin*. The Committee is expected to submit its final report in July 2000.

Improvements in Administrative Procedures: Despite provisions of the 1994 Administrative Procedure Law which were designed to make administrative procedures more transparent and fair, U.S. firms have repeatedly complained about the burdensome and unpredictable nature of such procedures in Japan. Under the Enhanced Initiative, the United States has called upon Japan to direct ministries and agencies to: (1) not require applicants to engage in prior consultations, i.e., discussions with the government entity regarding the content, scope or other aspects of a potential application, before formally accepting the application and commencing review of it; (2) where the government entity determines that an application does not contain all necessary information, provide the applicant with a written statement identifying all deficiencies in the application, the information that must be provided, and the legal authority for requesting such information; and (3) upon the request of an applicant, provide the applicant with a written statement of the status of the application and a statement as to when a decision (or disposition) of the application can be expected.

Use of Administrative Guidance: The lack of transparency inherent in Japan's excessive and extensive use of informal directives or "administrative guidance" remains a serious concern to the United States. Despite the 1994 Administrative Procedure Law's (APL) requirements that Japan provide, upon request, and in writing, a copy of administrative guidance to a private party receiving oral guidance from the Government or when it is issued to multiple persons, a Management and

Coordination Agency survey indicates that there have been few instances where this has occurred. Given that according to an OECD report, there have been only 33 public disclosures of administrative guidance despite the APL provisions on written guidance, the United States has urged Japan to take the appropriate actions to require all administrative guidance to be issued in writing, unless there is a specific compelling reason not to do so.

Private Sector Regulations: As Japan removes and relaxes regulations, it is essential that special public corporations *(tokushu hojin*), industry associations and other private sector organizations ("private regulatory organizations") are not allowed to substitute private regulations (*"min-min kisei"*) in place of government regulations. In addition, there is a need for greater transparency and monitoring of the role of private regulations in the Japanese economy. Private regulations, including rules on market entry and business operations, approvals, standards, qualifications, inspections, examinations and certification systems, can adversely affect business activities. Under the Enhanced Initiative, the United States has urged Japan to undertake a variety of measures, such as barring government entities from delegating governmental or public policy functions, such as product certifications or approvals, to private sector organizations, unless expressly authorized by a law, Cabinet order, ministerial ordinance or local ordinance.

IMPORT POLICIES

In the Uruguay Round, Japan agreed to "zero for zero" tariff eliminations on pharmaceuticals; paper and printed products; beer, whisky, and brandy; agricultural, medical, and construction equipment; furniture; steel; and toys. Japan also adopted the chemical harmonization initiative. It cut tariffs on copper and aluminum, with the top rate reduced from 12.8 percent to 7.5 percent. Japan is one of the 43 signatories to the 1997 Information Technology Agreement, which eliminates tariffs on the overwhelming majority of covered products by 2000. Japan's remaining high tariffs primarily affect agricultural and food products, including processed food products, wood and wood products, and leather and leather products. Tariffs on white distilled spirits were eliminated as a result of the December 1997 settlement of a WTO dispute. In late 1998, participants to the WTO initiative on pharmaceutical tariffs agreed to expand the product coverage to include new items, such as medicines for breast cancer and AIDS. While the United States, European Union, Canada and other participants met the target date for implementation of July 1, 1999, Japan has yet to implement the initiative.

At the APEC Leaders' meeting in Vancouver, Canada in November 1997, the United States, Japan and 16 other APEC economies endorsed a program of accelerated trade liberalization measures (the Early Voluntary Sectoral Liberalization, or "EVSL," initiative) in nine sectors: environmental goods and services, the energy sector, fish and fish products, toys, forest products, gems and jewelry, medical equipment and instruments, chemicals, and a telecommunications mutual recognition agreement. As the world's second largest economy, Japan's full participation in these initiatives was regarded as vital to ensuring their successful completion in 1998 as directed by APEC Leaders. Facing strong domestic pressure, Japan refused to participate in tariff reductions in the fisheries and forestry products sectors at the November 1998 APEC Leaders' Meeting, thereby blocking APEC's adoption of the policy package. However, it committed with other APEC nations to negotiate tariff reductions in all of the EVSL sectors in the WTO. Although the United States urged Japan to play a constructive role in the Accelerated Tariff Liberalization proposal (as the EVSL initiative became known in the WTO), Japan remained silent on the issue. Its lack of support was instrumental in preventing the formation of a consensus on this issue before the Seattle WTO Ministerial in November 1999.

Distilled Spirits

In July 1996, a WTO Dispute Settlement Panel ruled against Japan in proceedings initiated by the United States, Canada, and the European Union. The panel found that Japan's liquor tax regime discriminated against imported distilled spirits and was therefore inconsistent with Japan's WTO obligations. The United States was forced to seek binding arbitration when it became apparent that Japan did not intend to bring its tax system into WTO compliance within a "reasonable period" as provided for under WTO rules. The arbitration ruling in February 1997 supported the position of the United States. After considerable negotiation, the United States and Japan reached a settlement in December 1997 ensuring that Japan would bring its liquor taxation system into WTO conformity. Japan also agreed to eliminate tariffs on all brown spirits (including whisky and brandy) and on vodka, rum, liqueurs, and gin by April 1, 2002.

Japan is revising its liquor excise tax system in three stages: October 1, 1997; May 1, 1998; and October 1, 2000. Taxation rates for all distilled spirits were brought into WTO conformity by May 1998, with the exception of low-grade *shochu*. At the same time, the liquor tax for imported whiskey and brandy was reduced by 58 percent, while the tax on high-grade *shochu* was raised by 59 percent. The tax on low-grade *shochu* will be harmonized on October 1, 2000.

The U.S. distilled spirits industry reports that, as expected, the change in taxation has had a significant positive impact on exports of U.S. distilled spirits to Japan. In 1998, total exports of U.S. spirits to Japan increased by 23 percent over 1997 and grew faster than exports to other markets. The increase in U.S. distilled spirits exports is even more striking in light of Japan's sluggish economy, which has caused declines in overall U.S. exports to Japan. Growth tailed off during the first three quarters of 1999 for the industry as a whole, dropping almost nine percent on a year-on-year basis, although some segments (e.g., vodka) experienced growth of nearly 200 percent.

The United States will continue to closely monitor Japan's implementation of the settlement to ensure that tax and tariff reductions are eliminated under the agreed schedule, and that no measures are adopted that would undermine the settlement's benefits.

Varietal Testing

U.S. agricultural products such as apples, cherries, walnuts and nectarines have been subject to unnecessary phytosanitary restrictions. Japan has required repeated testing of established quarantine treatments each time a new variety of an already-approved commodity has been presented for export from the United States.

After efforts to resolve the varietal testing issue through bilateral negotiations over many years proved unsuccessful, in October 1997, the United States invoked WTO dispute settlement procedures against Japan. As a result, on March 19, 1999, the WTO Dispute Settlement Body (DSB) adopted panel and Appellate Body findings that Japan's varietal testing requirement was: (1) maintained without sufficient scientific evidence, in violation of Article 2.2 of the WTO Sanitary and Phytosanitary (SPS) Agreement; (2) not based on a risk assessment, in violation of Article 5.1; and (3) inconsistent with Japan's transparency obligations under paragraph one of Annex B, since Japan did not publish its requirements. The United States and Japan have been consulting since that time on Japan's implementation of the DSB's rulings and recommendations.

In addition to the WTO case, the United States last year was concerned with Japan's failure to lift its import ban on five apple varieties and two cherry varieties, despite U.S. Government testing that demonstrated the effectiveness of quarantine methods used by American producers for each variety. The United States discussed its concerns with Japanese officials at senior levels

in late 1998 and early 1999. Japan lifted its import ban on these varieties in mid-1999, in time for shipment of the 1999 crop of these U.S. products to Japan.

Fumigation Policies

Japanese plant quarantine regulations require fumigation of imported fresh horticultural products if, upon import inspection, a shipment is found to be infested with live insects, regardless of whether they are considered serious plant pests or are already present in Japan. The fumigation requirement is particularly detrimental to trade in delicate horticultural products, such as lettuce and cut flowers, which generally do not survive the treatment and must be destroyed. In fact, Japanese produce importers report that if the risk of fumigation were eliminated, imports of U.S. lettuce would grow dramatically. Due to the high risk of product loss due to fumigation, sales now typically average less than $5 million per year.

After repeated requests by foreign governments for reform, the Ministry of Agriculture, Forestry, and Fisheries (MAFF) has begun to implement a non-quarantine pest list by partially amending the Plant Quarantine Law to exempt 53 pests and 10 plant diseases from fumigation requirements. While this appears to be an important positive step, the list does not include common insects found on U.S. fresh fruits and vegetables, some of which are known to occur in Japan. The United States will continue to urge Japan in appropriate technical and deregulatory fora to develop a comprehensive list of non-quarantine pests and transparent inspection procedures in an effort to reduce excessive, unnecessary, and trade distorting fumigation.

Fresh Apples – Quarantine Requirements for Fireblight

Japan imposes overly restrictive quarantine restrictions on apples, hampering the ability of U.S. and foreign growers to access the Japanese market. Of particular concern are Japan's requirements that aim to prevent transmission of fireblight, which are enforced without sufficient evidence that apple fruit can transmit the bacteria. Japan's quarantine requirements for fireblight include three mandatory tree-by-tree inspections throughout the growing season and a requirement that all apples shipped to Japan be grown within a 500-meter buffer zone. The requirements significantly raise costs and reduce competitiveness of U.S. apples in Japan.

The United States has provided overwhelming evidence that the theoretical risk of transmitting fireblight through apple fruit is infinitesimally small and continues to urge Japan to eliminate or reduce the buffer zone to no more than 10 meters, and to end the tree-by-tree inspection requirement. Discussions between U.S. and Japanese scientists will continue this year in an effort to resolve this issue.

Fresh Potatoes – Golden Nematode and Potato Wart

Japan bans importation of fresh potatoes from the United States. MAFF officials maintain that the ban is necessary to prevent introduction of golden nematode and potato wart into Japan. The United States has challenged Japan's position, demonstrating that the golden nematode and potato wart disease are not found in the Pacific Northwest, California, and other U.S. potato exporting areas.

The United States has urged Japan to immediately lift the ban on fresh potatoes from areas not infested by the golden nematode and potato wart. In the most recent communication from Japan in July 1999, MAFF repeated its position prohibiting importation and raised new concerns regarding a number of viruses that would necessitate post-entry quarantine of imported potatoes even if approval were granted. The United States will continue to urge Japan to eliminate golden nematode and potato wart from the list of quarantine concerns for fresh potatoes.

Fresh Bell Peppers and Fresh Eggplant – Tobacco Blue Mold

Japan continues to ban imports of fresh bell peppers and fresh eggplant based on concerns over tobacco blue mold (TBM), without any evidence that the fruit of these plants are a host to the disease.

In initial bilateral discussions held in August 1999, the United States emphasized that the fruit of peppers and eggplants are outside any pathway of transmission of TBM. Similar to its initial position to ban all fresh tomatoes due to TBM (a ban which was lifted in 1999), Japan did not address the absence of evidence showing the fruit are a host to the disease and responded that records exist of natural infection. Through discussions in both bilateral and international fora, the United States will continue to press its case that the fruit do not transmit the disease.

Fish Products

Japan maintains nine global and two bilateral import quotas on fish products. U.S. fishery exports to Japan subject to import quotas include: pollock, surimi, pollock roe, herring, cod, mackerel, whiting, squid, and several other fish products. These quota-controlled imports into Japan account for hundreds of millions of dollars in sales annually, approximately one-fourth of total fishery exports to Japan. In the past several years, there has been a downward trend in sales of these import-quota-controlled items, largely due to the economic recession in Japan. During the Uruguay Round, Japan agreed to cut tariffs by about one-third on a number of fishery items, but avoided commitments to modify or eliminate import quotas. While Japan improved its administration of the import quotas on mackerel, jack mackerel and kelp in 1997, the application procedures and the lack of transparency on other fish products still cause concern for U.S. exporters. At the February 1998 session of the annual fishery trade consultations in Tokyo, the United States and Japan discussed problems pertaining to administration of fish import quota categories including the difficulty of separating pollock roe from cod roe under the Cod Roe IQ Category.

Japan also proved unwilling to support the APEC Accelerated Tariff Liberalization initiative (see "Import Policies" section of this chapter), thereby preventing a broader consensus from forming on the phase-out of tariffs on fish and fish products.

General Food Products

During the Uruguay Round, Japan agreed to bind tariffs on all agricultural products and to reduce bound rates by an average of 36 percent during 1995-2000, with a minimum 15 percent reduction on each tariff line. Japan also agreed to gradually reduce tariffs on imports of beef, pork, fresh oranges, cheese, confectionery, vegetable oils, and other items.

However, even after full implementation of the Uruguay Round cuts, a wide range of intermediate and consumer-oriented food and beverage products still face tariffs from between 10 and 40 percent, including beef, fresh oranges, fresh apples, waffles and other bakery products, confectionery, snack foods, ice cream, citrus and other fruit juices and processed tomato products. The import taxes raise food prices for consumers and cost U.S. food and agricultural exporters an estimated $500 million in lost sales every year. The United States will seek significant reductions in Japan's high-tariff regime for high-value foods through the WTO agriculture negotiations.

Japan also agreed in the Uruguay Round to convert all import bans and quotas (except for rice) to tariffs, which would be reduced between 1995 and 2000. Tariff-rate quotas replaced import quotas for wheat, barley, starches, peanuts, and dairy products. Japan retains state trading authority and price stabilization schemes for these products but is currently studying proposals to liberalize imports to a small degree.

The United States is closely monitoring Japan's implementation of the Uruguay Round measures for agriculture (particularly imports and exports

of rice) and safeguard measures for beef and pork. Our bilateral efforts have also focused on countering any technical or food safety-related measures, such as product standards and labeling issues, that appear to be unnecessary to protect health, safety or the environment and that could be a disguised form of protectionism.

Import Clearance Procedures

Despite progress in recent years, Japan's import clearance procedures remain slow and cumbersome by industrial country standards, resulting in increased costs for both U.S. exporters and Japanese consumers.

Continuing efforts by the United States and Japan to improve import clearance are being discussed under the Enhanced Initiative, as well as in regular bilateral consultations between customs agencies. These discussions have helped promote changes in Japan's import processing procedures, including establishing a prior classification information system using e-mail; eliminating the requirement to process all air cargo through a separate cargo holding area (Baraki cargo area) 30 kilometers from Tokyo's Narita airport; instituting a computerized customs processing system; and integrating that computer system with inspection authorities from the Ministry of Health and Welfare and the Ministry of Agriculture, Forestry, and Fisheries.

Although these changes have resulted in a reduction in the average time required for customs clearance, problems remain. Average processing times in Japan, for example, remain slow relative to other advanced industrial countries. A June 1999 Japan External Trade Organization (JETRO) survey showed that Japan's release time for ocean-going freight is more than three times as long as other countries surveyed (United States, U.K., Germany, France, and the Netherlands). As for airfreight, Japan's release time was shorter than that of the U.K., but longer than that of the United States and Germany.

In order to address these deficiencies, the U.S. Government and U.S. firms have urged Japan to: (1) facilitate the release of low-risk shipments (i.e., physical examination not required) at the point of arrival without transfer to a bonded area; (2) improve preclearance procedures so that prior to arrival, the customs administration and all other relevant Japanese Government agencies accept and process declarations, determine whether physical examination is required, and immediately notify the importer of the decision; and (3) implement an entry process that would permit a release determination based on a minimal amount of documentation, which would be followed by the complete documentation and then payment of duty.

In addition, user fees remain high. The United States has asked Japan to increase the import *de minimis* value for exemption from 10,000 yen (less than $100) to 30,000 yen in order to improve efficiency and reduce manpower requirements. The United States also has requested that Japan calculate dutiable import values on a "free on board" (FOB) rather than a "cost, insurance, freight" (CIF) basis.

Finally, customs processing hours of operation are too short. A change, from 8:30 AM-5:00 PM to 6:00 AM-10:00 PM hours of operation every day, including Saturdays, Sundays, and holidays, would bring processing hours for cargo in line with processing hours for passenger baggage, greatly benefitting importers and facilitating onward transportation. The U.S. Government and U.S. companies have also requested that Japan establish procedures to effect customs release of cargo 24 hours per day by implementing a surety bond system, bank guarantee, or "round-the-clock" bank clerk.

Given the wide-ranging effect of customs clearance costs and delays on current and potential U.S. exporters, catalog retailers, courier services, and Japan-based enterprises which require the importation of goods and equipment, it is difficult to estimate the dollar effect of streamlining Japanese customs procedures. However, one U.S. courier has estimated that changing the *de minimis* exemption alone would reduce annual duties by tens of billions of yen, while encouraging

dramatic increases in orders from Japanese consumers.

Leather

In 1991, Japan liberalized treatment of footwear imports, setting a footwear quota of 2.4 million pairs per year. By JFY 1998, it had raised that quota to roughly 12 million pairs per year. In the Uruguay Round, Japan committed itself to reduce tariffs over an eight-year period on under-quota imports of leather footwear, crust leather and other categories.

The process by which quotas are established by Japan lacks transparency. U.S. industry reports that there is no consultation with leather shoe importers to determine anticipated import levels. Indeed, Japanese authorities make no effort to limit quota allocations to firms that plan to use them. The U.S. Government and U.S. leather and leather footwear industries continue to seek elimination of these quotas.

Above-quota imports of footwear still face stiff market access barriers. Effective January 1, 2000, the above-quota tariff is 37.5 percent or 4,425 yen per pair, whichever is higher. These rates will decline to 30 percent or 4,300 yen, whichever is higher, by 2002. In principle, the over-quota tariff rate will be reduced by 50 percent and the yen minimum alternative rate by 10 percent over the eight-year phase-in period. In practice, however, the yen minimum alternative rate is applied in a manner that negates the effect of the larger tariff rate reduction. Moreover, while above-quota imports grew substantially in JFY 1998, they still totaled only about 5.9 percent of under-quota imports, suggesting that the higher rates for above-quota imports are discouraging additional imports.

Rice

Japan's highly protected rice market has long been a target for liberalization efforts. During the Uruguay Round, Japan agreed to begin to open its domestic rice market and establish a minimum access commitment for rice imports. Japan committed to import 379,000 metric tons in 1995/1996. This quota was to grow to just over 758,000 tons at the end of the Uruguay Round implementation period (2000/2001). Since the Uruguay Round, the United States has been the single largest foreign supplier of rice to the Japanese market, supplying approximately one-half of Japan's total imports.

On April 1, 1999, a new Japanese rice regime went into effect that transformed the existing import quota system into a tariff quota system. Under "tariffication," a specific duty is applied to imports outside of Japanese minimum access rice imports. By adopting a tariff quota system, Japan is allowed to reduce the annual growth rate of its minimum access rice imports to 0.4 percent. Japan therefore imported 644,000 metric tons (milled basis) in 1999, 38,000 tons less than would have been imported under the previous regime.

Despite Japan's Uruguay Round commitments, full market access for American rice has not been achieved. Rice imported by the Japan Food Agency (JFA) under the ordinary tender system rarely reaches end consumers. These imports are either placed into stocks or exported as food aid. U.S. exporters are further prevented from direct contact with Japanese consumers by the JFA's management of the simultaneous-buy-sell (SBS) system. The SBS system was designed to allow Japanese importers and foreign rice exporters to meet the demand of Japanese consumers without interference from the JFA.

Under the current administration of the SBS, however, there is little opportunity for Japanese consumers to choose imported rice. They do not have the ability to purchase rice identifiable as U.S.-origin, because American rice is blended with cheaper, poorer quality rice from other sources, preventing U.S. rice from competing against other imported rice of similar variety and quality. In addition, shipment of imported rice must occur within 60 days of an SBS tender, effectively preventing establishment of a steady 12-month supply to Japanese wholesalers.

The U.S. rice industry has worked assiduously to meet the demands of the Japanese market. In cooperation with its Japanese customers, it has improved its production, handling, and milling techniques for the unique varieties that are produced specifically for Japan's market. To advance this effort, the U.S. rice industry has actively engaged in technical discussions with Japan. The U.S. rice industry also made tremendous efforts to improve its price competitiveness under the SBS tendering system. For JFY 1999, the SBS average purchase price for U.S. rice (84,201 yen per metric ton) was 26 percent lower than the JFY 1998 average purchase price (114,238 yen per metric ton) and the lowest ever offered by the United States under the SBS system. In contrast, the JFY 1999 average SBS mark-up for U.S. rice (189,885 yen per metric ton) was the second highest in nominal terms and the highest in terms of effective *ad valorem* duty rate (226 percent) since introduction of the SBS rice tender system.

The United States held a number of discussions with the Government of Japan to examine the effects of the new tariffication policies on access to Japan's rice market. Through these talks, the United States conveyed its expectation that the U.S. rice industry would achieve continued access to Japan's rice market in line with that of the past four years. At the same time, the United States and Japan agreed to hold periodic consultations on a number of agricultural issues, including access to Japan's rice market. The first such meeting took place September 1999 in Geneva. At that meeting, the United States urged that the Japan Food Agency administer its import system in a transparent manner that would allow U.S. rice exporters to develop effective commercial relationships with end-users in Japan and to give consideration to revising the SBS system so that the market is allowed to function in its normal way and that SBS licenses are not awarded on the basis of JFA profits.

The U.S. market share of Japanese rice imports under Uruguay Round minimum access requirements increased from 47.7 percent in JFY 1998 to 47.9 percent in JFY 1999, in line with U.S. expectations. The United States is closely monitoring Japan's rice purchases and will consider all of its options to respond to Japan's policies in the event that circumstances change.

During JFY 1999, MAFF established a new fund to purchase 170,000 metric tons of excess rice crop and release the same amount of older, government-owned stock as rice for feed-use. The fund subsidized the large price difference between food-use and feed-use rice, which amounts to about 200,000 yen ($1,900) per metric ton. This is not the first time that MAFF has utilized such disposal measures. Previous disposals amounted to 13 million metric tons at a cost of some three trillion yen ($25 billion). This time, the feed disposal volumes are smaller, but the cumulative effect over 30 years sharply reduces feedgrain imports and disrupts the world rice market.

Wood Products and Housing

Japan remains the top U.S. export market for wood products. Exports of U.S. forest products totaled $1.5 billion in calendar year 1999, down three percent from the level in 1998. The sluggish housing market, a sector utilizing a major share of imported wood products, caused this decline.

To expand the market for U.S. wood products in Japan, the United States has urged Japan to remove remaining barriers, such as prescriptive codes and standards in the Building Standard Law, Japan Industrial Standard (JIS), and Japan Agricultural Standard (JAS). These barriers limit the approval and acceptance of imported building materials.

In addition to reform of the regulatory environment, there is much that Japan can do to develop its wood products market, including taking steps to rebuild consumer confidence in order to increase home purchases, continue changes to the tax system to stimulate the new and used home market, reform its land and lease laws, expand the home mortgage system, and

eliminate subsidies for its domestic wood products sector.

Another longstanding U.S. objective in Japan has been the elimination of tariffs on value-added wood products. Japan's failure to support the Accelerated Liberalization initiative (see "Import Policies" section of this chapter) precluded agreement on a phase-out of tariffs for wood products (i.e., wood, paper, printed materials, and wooden furniture). The United States will continue to urge Japan to play a constructive role in concluding an agreement in the context of any new WTO negotiations with a view to eliminating wood product tariffs in the 2002-2004 time frame.

Housing has been designated as one of five priority sectors under the Enhanced Initiative. Facilitation of wood-frame construction is a central U.S. objective in housing discussions under the Initiative, and progress in this area is described in detail in the deregulation section of this report. In addition to meetings held in connection with the Enhanced Initiative, the United States and Japan discuss wood product and housing material issues in the Building Experts Committee, the JAS Technical Committee, and the Wood Products Subcommittee.

Marine Craft

Japan's non-transparent system of small craft safety regulation for boats, marine engines, and marine equipment is a serious impediment to market access in this sector. The regulations, which are administered by the Ministry of Transportation and the Japan Craft Inspection Organization, are often vague and subject to arbitrary and inconsistent interpretation. Testing requirements can be expensive, while documentation requirements are non-transparent and burdensome, forcing companies to disclose sensitive proprietary information about product design, material specifications, and manufacturing techniques. Inspection fees are high and unrelated to the costs of conducting the inspections.

This regulatory system unnecessarily increases the costs of U.S. manufacturers, burdens Japanese consumers with higher prices and reduced access to imported boats, motors, and equipment, and provides no increased safety benefits compared with U.S. and European regulations. Japan has in the past expressed its intent to adopt international safety standards for small craft and marine engines, and participates actively on international standards drafting committees. Japan has made little progress, however, in harmonizing its small craft regulations with international practices. The United States will continue to raise its concerns with Japan regarding this issue under the Enhanced Initiative.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Certification-related problems continue to obstruct access to Japan's markets. Although advances in technology continue to make Japan's standards outdated and restrictive, Japanese industry continues to support safety and other standards that are unique to Japan and which restrict competition. In some areas, however, Japan has undertaken to simplify, harmonize, and eliminate restrictive standards in accordance with international practices.

The principal organization that adjudicates standards and certification disputes between foreign firms and the Government of Japan is the Office of Trade and Investment Ombudsman (OTO). In 1994, the OTO came under the Prime Minister's Office and was authorized to recommend actions to appropriate ministries. The OTO has had some modest impact, but still lacks formal enforcement authority.

Biotechnology

Japan has adopted a largely scientific approach in its approval process for genetically modified (GM) foods. To date, MAFF and the Ministry of Health and Welfare (MHW), which regulate biotechnology products, have approved the importation of 29 GM plant varieties, including corn, potatoes, cotton, tomatoes, and soybeans.

While U.S. and Japanese regulatory approaches to assessing the safety of biotech products have been closely aligned, the United States is very concerned by Japan's recent decision to implement mandatory labeling of 24 whole and semi-processed foods made from corn and soybeans beginning April 2001. The United States is concerned that mandatory labeling will discourage consumers from purchasing foods derived through biotechnology by suggesting a health risk when there is none. In fact, in response to the release of MAFF's plans to require labeling, many manufacturers of products to be subject to mandatory labeling have already switched, or have declared they will switch, to non-genetically engineered ingredients.

MAFF has stated that the objective of extending a mandatory labeling requirement to food that has been produced through biotechnology is to provide information to the consumer. The United States has informed MAFF that it is important for consumers to have information on foods that have been genetically engineered, but that alternatives to labeling, such as educational materials and public fora, can collectively provide more meaningful information to consumers on genetic engineering. The United States will continue to consult closely with Japan in both bilateral and multilateral fora to address outstanding issues in this important area.

Dietary Supplements

Dietary supplements (vitamins, minerals, herbs, and non-active ingredients) have traditionally been classified as drugs in Japan. As a result, severe restrictions are imposed on the shape, dosage, and retail format for such supplements. These regulations create excessive costs and difficulties for most foreign supplement firms participating in the Japanese market, thus contributing to the relatively weak presence of U.S. firms. Dietary supplement issues are addressed by the United States through the MOSS/Enhanced Initiative process.

In March 1996, Japan's Office of Trade and Investment Ombudsman (OTO) recommended that products normally distributed and sold abroad as food products should not be regulated as drugs, but be allowed into the market as food products in Japan. However, MHW's actions have yet to realize the spirit of the OTO recommendations.

Under Japan's liberalization process, some herbs, minerals and vitamins have been designated as foods; however, this treatment does not solve the marketing and labeling problems for U.S. industry because as food, such supplements must now adhere to the food additive restrictions of the Food Sanitation Law (FSL). Products containing common excipients used to make tablets that do not appear on the positive list of food additives under FSL still cannot be sold in Japan. Another problem presented by the FSL is that some naturally occurring compounds, such as benzoic acid and sodium benzoic that are found in ginkgo biloba, are also considered food additives. Accordingly, such restrictions make the marketing of such products without major reformulations impossible.

MHW established a study group composed of government, industry, and academic experts to study the treatment of dietary supplements. This body released an interim report in December 1999 for public comment, which was discussed at the January 2000 MOSS/Enhanced Initiative consultations. The report, to be finalized by April 2000, will address all aspects of dietary supplement regulation in Japan and serve as the basis for MHW's adoption of OTO's recommendations. The United States welcomes the use of a public comment period for the interim report and urges Japan to fully implement the OTO recommendations, for example, by creating a mechanism for expedited review and approval of excipients used in pharmaceuticals; allowing minerals, vitamins, and herbs to make nutritional and health benefit claims if there are scientific data and information to support such claims; clearly publishing the criteria by which approvals of herbs, minerals, vitamins, excipients, and nutritional/health benefit claims are judged; and utilizing foreign data and information to

evaluate and approve products in Japan without requiring supplemental domestic data.

The United States will continue to engage MHW in the MOSS/Enhanced Initiative process, the OTO, and other fora, to improve market access for U.S. dietary supplements through full and meaningful implementation of the OTO recommendations.

Food Additives

Processed food imports into Japan have at times come into conflict with Japan's standards affecting food additives, even though such additives may be approved as safe in other countries by the Joint FAO/WHO Experts Committee on Food Additives. For example, Japan refuses to allow the importation of light mayonnaise (as well as creamy mustard) containing the food additive potassium sorbate, a food additive evaluated and accepted by numerous national and international standard-setting organizations. Other food products containing this additive, however, are permitted to enter Japan.

Through revisions to its Food Sanitation Law (FSL), Japan is working to harmonize its national regulations to conform with the provisions of the WTO Sanitary and Phytosanitary (SPS) Agreement. Currently, Japan's food additive regulations remain unique, especially the listing of "non-natural" additives designated by MHW pursuant to Article 6 of the FSL. The U.S. Government encourages U.S. firms and industry associations to file applications with MHW for approval of new additives, allowing sufficient time for assessment. The United States has raised Japan's regulation of food additives under the Enhanced Initiative and intends to continue to urge Japan to adopt regulations which both protect consumers and facilitate international food trade.

Pesticides Residue

The Ministry of Health and Welfare continues to establish new residue standards for pesticides, providing full notification – including the opportunity to comment and review – to the WTO. The U.S. Government is providing scientific data pertaining to relevant U.S. and international standards for the chemicals concerned.

While Japan has made progress in establishing pesticide residue standards in harmony with internationally recognized tolerance levels, further work with Japan is necessary to help ensure that non-tariff barriers regarding imported food and agricultural products do not unreasonably restrict trade.

Veterinary Drugs

Japan typically waits for the joint FAO/WHO Codex Alimentarius Commission (Codex) to adopt an international standard before evaluating scientific evidence. However, such a policy results in unnecessary delays in establishing tolerance levels for veterinary drugs in Japan. The practice in Japan of prohibiting detectable residue levels of these drugs, without conducting a risk assessment in a timely manner, may be at odds with Japan's obligations under the WTO SPS Agreement. The United States has urged Japan to undertake evaluation of scientific evidence in order to establish tolerance levels for new veterinary drugs in a timely fashion, and not to delay the process while waiting for the outcome of Codex deliberations, thereby improving the safety review process for veterinary drugs sold in Japan.

GOVERNMENT PROCUREMENT

The United States has concluded bilateral agreements with Japan in six key sectors of the Japanese public sector market: computers, construction, medical technologies products and services, satellites, supercomputers, and telecommunications equipment and services. The aim of these agreements is to improve foreign firms' access to, and expand sales in, Japan's public procurement market. In support of this, the agreements attempt to redress traditional Japanese procurement practices that have historically prevented U.S. and other

foreign firms from fully and equally participating in Japan's public sector market. In general, the agreements provide equal access for foreign and domestic suppliers to all public information at all phases of the procurement process; ensure equal opportunity to comment on and participate in the development of specifications; provide for a reduction in the number of sole-sourced procurements; and require an impartial bid protest system.

Computers

U.S. producers of computer goods and services are global leaders in technology and performance and continue to be among the largest and most successful foreign firms in Japan. To address the fact that these firms were notably under-represented in the Japanese public sector market for computers, the United States and Japan concluded a bilateral Computer Agreement in 1992. The agreement, whose aim is to expand government purchases of foreign computer products and services, made procedural improvements in Japan's public sector computer procurement regime, with provisions requiring that: (1) equal access to information and opportunity to participate will be available to all potential bidders; (2) any company that has participated in developing specifications for a procurement will be barred from bidding on that same procurement; (3) sole sourcing will be restricted to exceptional cases justified under the GATT/WTO Agreement on Government Procurement; (4) evaluation of bids will be based upon a range of criteria set forth in the tender documentation; and (5) unfair low bids will be prohibited.

At the annual bilateral review of the agreement held in Tokyo in May 1999, Japan presented JFY 1997 data showing that foreign computer firms held 16.5 percent of the public sector market – a 0.6 percent increase over the previous year. However, this followed a 37 percent plunge in Japanese public procurement of foreign computer goods and services between JFY 1995 and JFY 1996. The United States recognized that there had been some movement in a positive direction, but expressed serious concern that, according to Japanese Government data, the foreign share of the public sector computer market was still roughly equivalent to the share that foreign companies held when the Computer Agreement was concluded. Further, the data presented by Japan continues to compare unfavorably with a fairly consistent foreign market share of more than 30 percent of Japan's private sector computer market. The United States concluded that more work needed to be done by Japan to ensure that the objective of the agreement is achieved.

In 1999, given the continued gap between the U.S. share of the Japanese private and public sector computer markets, as well as the rapid technological advancements in this sector, the United States urged Japan to update and improve the implementation of the Computer Agreement. To this end, the United States proposed that Japan more fully utilize the Internet for public procurements, broaden its use of "overall greatest value method" (OGVM) in bid evaluations, and provide advance information to potential bidders on a larger number of upcoming procurements.

Japan has announced its intention to consolidate central government procurement announcements and documentation on the Internet, and in late 1999, outlined plans to create a formal committee early in 2000 to launch this effort. Japan's eventual goal is to create a single Internet site where all Japanese central government procurement information necessary for bidding for all product categories will be available, and to make bidding on the Internet possible as well. The United States has urged Japan to ensure that the views of foreign computer producers are fully taken into account as Japan proceeds with this initiative.

Construction, Architecture and Engineering

There are two U.S.-Japan public works agreements – the 1991 Major Projects Arrangement (MPA) and the 1994 U.S.-Japan Public Works Agreement, which includes the Action Plan on Reform of the Bidding and Contracting Procedures for Public Works

("Action Plan"). The MPA was designed to improve access to Japan's public works market and includes a list of 40 projects on which international cooperation is encouraged. Under the Action Plan, Japan must use open and competitive procedures on procurements valued at or above the thresholds in the WTO Agreement on Government Procurement (GPA). The United States is seriously disappointed with the continued lack of progress under these agreements. From July 1998 to July 1999, for the second year in a row, foreign design and construction firms won only $50 million in Japanese public work contracts. Since July 1999, foreign firms have been awarded only $40 million in contracts. The U.S. share of Japan's $250 billion public works market has consistently remained well under one percent – a troubling fact given the competitiveness of U.S. firms around the world. Proportionally, Japanese firms earn 12 times as much public construction business in the United States as American firms do in Japan.

Japan's public works market is well known for its closed nature and for the prevalent use of bid-rigging (or "*dango*"), under which companies consult with one another and prearrange a bid winner. In 1999, the JFTC investigated a network of nearly 300 Japanese civil engineering consulting firms involved in pre-determining winners on 2,500 public consulting contracts in Chiba Prefecture. As a result of its investigation, the JFTC prohibited these companies from bidding on public contracts for only two months. The United States has urged the JFTC to take further and stronger action in this area.

Because of the lack of progress in this sector, the United States and Japan met, at the U.S. Government's request, for special out-of-cycle consultations on the agreements in January 1999, and at the Under Secretary level for both the July 1999 annual review and out-of-cycle consultations in January 2000. The United States highlighted those practices which continue to deny full market opportunities to U.S. firms, including: (1) arbitrary restrictions on joint venture formation for large construction projects, including the "three-company joint venture rule" which limits the number of joint venture participants to three; (2) the very low number of design/consulting projects open to foreign firms; and (3) continued use of vague and unreasonable definitive criteria.

In January 2000, the United States expressed its serious disappointment that Japan had not acted on several suggestions made by the Under Secretary in July 1999, noting that some commissioning entities, including the Ministries of Health and Welfare, Post and Telecommunications, and Agriculture, Forestry, and Fisheries have never awarded an Action Plan procurement to a U.S. firm. No progress has been made with the Ministry of Construction (MOC) in liberalizing joint venture requirements for construction projects despite repeated requests from the United States for elimination of the three-company joint venture rule. During the July 1999 annual review, Japan and the United States agreed to the creation of the U.S.-Japan Construction Cooperation Forum, which is designed to facilitate the formation of joint ventures between U.S. and Japanese firms, and to make it possible for U.S. companies to participate more fully in Japan's public works market. The first Forum was held in October 1999, and Japan agreed to hold the second Forum in the Spring of 2000. The United States anticipates that these Forum meetings will lead to more contracts for U.S. firms.

In the design/consulting area, Japan has launched three initiatives since 1998. However, during the January 2000 review, it was clear that the number of design/consulting procurements covered by the Action Plan has not increased despite these initiatives. Of particular concern is the lack of progress in the initiative under which two types of design contracts (basic design and execution design) are combined when determining if the procurement meets the Action Plan threshold. This initiative, in effect, cuts the threshold for coverage in half and allows contracts in separate fiscal years to be combined. The United States believes that, were this initiative fully implemented, there would be a significant increase in the number of

design/consulting procurements covered by the Action Plan. The other two initiatives involve contracting out design work and allowing design/consulting firms greater freedom to form joint ventures. The United States also was disappointed that no progress had been made in establishing a mode Program Management/Construction Management (PM/CM) project.

In addition, during the January 2000 review, the United States repeated its concerns regarding Japan's continued use of vague and unreasonable definitive criteria and cited recent design/consulting and construction cases, including MOC-commissioned procurements. The United States urged Japan to define the criteria used in particular procurements so as to maximize, rather than restrict, the number of firms that would be able to participate in the procurement. The United States also is concerned that some commissioning entities, including Japanese prefectural and local governments covered by the WTO GPA, may deliberately calculate the value of procurements such that they fall below the GPA thresholds, and thus do not need to be opened to foreign firms.

Although the 1994 agreement has no expiration date, the mechanism requiring annual meetings between the United States and Japan expires on March 31, 2000, unless the two governments mutually agree to continue the discussions. (The consultative mechanism under the MPA remains in place until all MPA projects are completed.) The United States believes continuation of government-to-government discussions on Action Plan implementation is needed given the continuing problems in this sector.

The United States is monitoring several projects covered by the public works agreements, including the Central Japan International Airport, Kansai International Airport Second Runway Construction, New Kitakyushu International Airport, Haneda Airport, Second Keihan Expressway, Kyushu University Relocation Project, and Kyushu National Museum. During the recent reviews, the United States highlighted these projects, as well as projects funded by Japan's fiscal stimulus packages, as being of particular interest to U.S. firms.

Medical Technology

The United States and Japan concluded the Medical Technology Agreement in November 1994, with the goal of significantly increasing market access and sales of competitive foreign medical products and services in the Japanese public sector procurement market. U.S. firms continue to be the world's largest producers of advanced medical technologies, and this agreement provides an important step forward in enabling them, as well as other foreign firms, to more effectively sell medical technology products and services in Japan's public sector.

The agreement sets out fair and transparent procedures that must be used by governmental entities in procuring major medical equipment and services. It also contains a set of quantitative and qualitative criteria upon which its implementation may be annually assessed, including value and share of contracts awarded to foreign firms by each government entity; number and value of contracts awarded through single tendering; and foreign access to procurement information. A key element of the agreement is the requirement that procurement decisions for central government purchases above a specified threshold (lowered to 385,000 Special Drawing Rights on April 1, 1998) be made on the basis of the "overall greatest value method" (OGVM) of bid evaluation, instead of on the lowest-bid. This is important because U.S. equipment generally is more innovative and offers special features or extraordinary performance, and OGVM permits procurement decisions based not just on initial price, but on a complete assessment of the product's value over its life cycle. This ensures that buyers have the flexibility to select products based on the most favorable combination of price and performance.

Through the MOSS/Enhanced Initiative process, the United States urged Japan to undertake the needed measures to allow prefectural and local

governments to use OGVM in bid evaluation. On February 17, 1999, Japan adopted a Cabinet order permitting the use of OGVM in procurements made at the local and prefectural level. This new policy should expand market access in Japan for U.S. exporters and manufacturers of not only highly advanced medical devices, but of a wide-range of high technology products. According to U.S. industry estimates, this measure could represent an increase in U.S. sales to Japan of approximately $500 million – an estimated $100 million of which could come from sales of U.S. medical devices alone.

The most recent annual review of the agreement was held in September 1999. Japan presented data for JFY 1997 which showed that foreign market share rose 4.4 percentage points to 45.6 percent of the market. This occurred despite the fact that overall procurement covered by the agreement fell 29.6 percent between JFY 1996 and JFY 1997 (from over 75 billion yen to 53 billion yen). Foreign/domestic head-to-head competition also increased significantly in JFY 1997 – 14.7 percent of contracts versus seven percent in JFY 1996, showing more dynamic competition occurring in this sector.

While significant progress has been made under this agreement, the United States continues to urge Japan to make further progress by improving transparency in Japan's public procurement process and expanding the use of OGVM at the local and prefectural levels.

Satellites

Under the 1990 U.S.-Japan Satellite Agreement, Japan committed to open non-R&D satellite procurements to foreign satellite makers. As defined in the agreement, "R&D" satellites are those designed and used entirely, or almost entirely, for the purpose of in-space development and/or validation of technologies new to either country, and/or non-commercial scientific research. Satellites designed or used for commercial purposes or for the provision of services on a regular basis expressly do not meet the agreement's criteria defining R&D satellites. Coverage of the agreement includes procurement for broadcast satellites by Nippon Telegraph and Telephone (NTT) and the Japan Broadcasting Corporation (NHK), the government-owned television/radio services.

To date, the agreement has been successful in opening the Japanese Government's procurement market to foreign competition. From 1990 through 1999, U.S. satellite makers – world leaders in this field – won all six contracts (with a combined value exceeding $1 billion) openly bid for under the competitive procedures outlined in the agreement. Given U.S. firms' strength in this area, the United States expects that this success will continue.

The United States continues to carefully monitor Japan's adherence to the terms of the agreement and to ensure that no overly-broad definition of an R&D satellite is used that could unfairly deny U.S. satellite manufacturers access to procurement opportunities.

Supercomputers

The United States and Japan concluded the 1990 U.S.-Japan Supercomputer Agreement in order to ensure fair access for U.S. supercomputer manufacturers to Japan's high-performance computing market. Under the agreement, Japan committed to implement transparent, open, and non-discriminatory competitive procurement procedures for supercomputers in the public sector and to ensure that procuring entities are fully able to procure the supercomputer that best enables them to perform their missions.

Results under the 1990 Supercomputer Agreement generally have been mixed. A significant gap remains between the U.S. share of the competitive Japanese private sector and public sector supercomputer markets. After a notable increase in the U.S. share of Japan's public sector supercomputer market in JFY 1993 and JFY 1994, which brought it close to the U.S. firms' 45-50 percent share of the Japanese private sector supercomputer market, more recent results under the agreement have been much less promising. U.S. firms won only one

of eleven procurements in JFY 1995, two of eight procurements in JFY 1996, one of five procurements in JFY 1997, two of fifteen procurements in JFY 1998, and two of nine procurements in the first eight months of JFY 1999. In addition to the discrepancy between the U.S. share of Japan's public and private sector markets, in recent years, the United States raised concerns over the use by certain Japanese public sector entities of inappropriate technical requirements in public supercomputer procurements. The United States will continue to press Japan to ensure that the terms of the bilateral supercomputer agreement are faithfully implemented, including the use of neutral and nondiscriminatory technical requirements.

On April 30, 1999, the United States and Japan agreed in an exchange of letters to increase the threshold governing coverage of the Supercomputer Agreement from five billion floating point operations per second (GIGAFLOPS) to fifty GIGAFLOPS in order to keep pace with the notable advance in technology in this sector. This change went into effect on May 1, 1999.

Telecommunications

NTT Arrangement: On July 1, 1999, concurrent with the restructuring of NTT into a holding company (Nippon Telegraph and Telephone Corporation), two regional companies (NTT East and NTT West), and a long distance/international company (NTT Communications), the United States and Japan reached agreement on a new NTT Procurement Agreement. This agreement replaced the previous NTT Agreement, which was first concluded in 1980 and subsequently renewed six times. Together, the four NTT successor companies continue to be Japan's single largest purchaser of telecommunications equipment, and according to recent statistics, account for about one-third of Japan's $30 billion telecommunication equipment market. As such, the "NTT market" has been and continues to be of keen interest to U.S. and other foreign telecommunications firms.

The new agreement covers the procurement of all four of the NTT successor companies and will remain in force for two years. In terms of substance, the new agreement: (1) ensures continued government oversight of NTT successor companies' procurement; (2) commits both governments to annual reviews to assess progress; (3) requires NTT successor companies to provide data for review by the governments; and (4) sets forth new, streamlined procurement procedures in which the NTT successor companies commit to procure in an open, non-discriminatory, competitive and transparent manner. Reflecting changes brought about by NTT's restructuring and the changing business environment in which domestic and foreign suppliers and the NTT successor companies are now operating, the agreement provides details on how three methods of procurement will operate: (1) the traditional "request for proposal" method; (2) a means by which companies with innovative products can approach NTT directly with proposals; and (3) a means by which NTT will conduct follow-on purchases.

In October 1998, during the last bilateral review of the previous U.S.-Japan NTT Procurement Agreement, NTT reported that overall procurement of foreign products increased from 173 billion yen in JFY 1996 to 185 billion yen in JFY 1997. The fact that overall NTT procurement of goods and services declined in JFY 1997 made that increase all the more significant. The United States believes that this is an indication that the NTT Agreement has been effective in moving closer to its objective of increasing competition and improving the openness, fairness, and transparency of the telecommunications equipment market in Japan. Nonetheless, at this review and in subsequent negotiations related to the new NTT Agreement, the United States expressed its expectation that there will be continued growth in the NTT successor companies' procurement of foreign equipment, and that the foreign share of procurement by NTT successor companies will increase to levels more consistent with those of Japanese private sector telecommunications carriers (which have traditionally been far more open to foreign products) and with

telecommunications markets globally. Because the NTT successor companies procure over $10 billion in equipment and services annually and plan to increase procurement of data- and Internet-related technologies, an area in which U.S. companies are particularly strong, improved access to the "NTT market" should result in significant new opportunities for U.S. firms. The first annual review under the new NTT Agreement will be held in the second half of 2000.

Public Sector Procurement Agreement on Telecommunications Products and Services: The objective of the 1994 U.S.-Japan Telecommunications Procurement Agreement is to significantly increase access for foreign telecommunications products and services to Japan's public sector. Pursuant to the agreement, Japan has introduced procedures to eliminate barriers such as: unequal participation in pre-solicitation and specification-drafting for large-scale telecommunications procurements; ambiguous award criteria; and excessive sole sourcing. The agreement also includes quantitative and qualitative criteria for measuring progress such as: (1) annual value and share of purchases of foreign products; (2) annual procurements of foreign products and services by entity; (3) contracts awarded for foreign products and services by entity; (4) annual numbers and values for contracts awarded as a result of single tendering; and (5) new subcontracting opportunities for foreign suppliers.

During the annual review held in May 1999, during which JFY 1997 data was reviewed, the United States expressed serious concern about the continued low foreign share of Japanese Government procurement of telecommunications products and services, which Japanese Government data showed to be 3.9 percent. While foreign firms had achieved a 13 percent market share in JFY 1995, this decreased to 3.5 percent in JFY 1996. While there was a slight increase in JFY 1997, the trend evident in this sector continues to stand in direct contrast to the significant successes that foreign suppliers have had in selling to Japan's private sector, particularly the new competitors to NTT, which purchased 28 percent more foreign goods and services in 1997 than they did in 1996.

During the May review, the United States expressed disappointment over Japanese agencies' over-reliance on and increasing use of sole-source tendering for procurement. Despite the fact that the agreement calls for a reduction in sole-source tendering, the percentage of sole-source tendering in total government telecommunications procurements reached 27 percent in JFY 1997. The Ministry of Posts and Telecommunications, the largest government purchaser of telecommunications equipment and services, sole sourced fully one-third of these procurements. The Ministry of International Trade and Industry also relied heavily on sole sourcing.

Also at the review, the United States expressed serious concern regarding Japan's failure to provide information on procurements made by the Japan Defense Agency, despite the fact that the Agency is explicitly covered under the bilateral agreement. It also questioned the absence of data from Japan Railways. Finally, the United States expressed concern about agencies' use of Japan-specific standards, specifications that appear biased toward a particular local firm, and short timeframes for bids that effectively freeze out foreign suppliers.

The next annual review is scheduled for the Spring of 2000.

INTELLECTUAL PROPERTY RIGHTS PROTECTION

The United States has pursued its intellectual property goals with Japan through a firm policy that has combined close bilateral consultations and negotiated agreements (including two bilateral patent agreements from 1994); effective policy coordination in multilateral and regional fora; and strong action in the WTO when necessary to defend U.S. intellectual property interests in Japan.

The sound recordings dispute of 1996-97, which represented the first intellectual property dispute settlement case at the WTO, was resolved when Japan amended its law to fulfill its obligations in the U.S. favor. The result of this policy has been an increase in the level of protection afforded U.S. intellectual property in Japan, and a greater Japanese role in pushing for stronger worldwide intellectual property protection. Although intellectual property piracy in Japan has dropped and significant improvements have been made to Japan's legal and administrative intellectual property framework, the United States has identified a number of areas where further action by Japan is needed, including: (1) addressing persistent patent-related problems; (2) improving and expanding protection of copyrighted works; (3) expanding protection for well-known trademarks; (4) affording greater protection of trade-secret information; and (5) illuminating and gaining access to non-transparent border enforcement mechanisms. Due to the existence of such concerns, in April 1999, Japan remained on the Special 301 "Watch List" of countries from which the United States seeks stronger intellectual property rights protection.

Patents

The United States has focused particular attention on improving registration access and approvals, and reforming Japan's practice of affording only narrow patent claim interpretation. Japan has taken steps to implement its commitments under two 1994 bilateral patent agreements, which: allow patent applications to the Japan Patent Office (JPO) to be filed in English; permit the correction of translation errors after patent issuance; end dependent patent compulsory licensing (except in cases where anti-competitive practices have been found); end the practice of allowing third parties to oppose a competitor's patent before it is granted and to hear all opposition claims at the same time; and provide a revised accelerated examination system. Notwithstanding these steps, the United States remains concerned with several aspects of Japan's patent administration, including the relatively slow process of patent litigation in Japanese courts, the lack of an effective means to compel compliance with discovery procedures, and the lack of adequate protection for confidential information produced relative to discovery.

A revised patent law passed the Diet in 1999 and went into effect January 1, 2000. This law is designed to make it easier for plaintiffs to prove patent infringement in courts. Key provisions include increasing requirements on alleged violators to justify their actions, obligating alleged violators to cooperate with calculation experts, giving judges discretion over the amount of damages, increasing the penalty in cases where patents were obtained fraudulently, and allowing courts to seek technical advice from the JPO. The United States will monitor closely whether this revision reduces the burden of proof required by Japanese courts that a patentee's process is actually being used, which has been particularly onerous to foreign patent owners.

Starting October 1, 2000, the period between when a patent is applied for and must be pursued by an applicant will decrease from seven to three years. The JPO has set a target of reducing the examination period further to 12 months by the end of 2000. Moreover, a government advisory panel released a report in December 1999 urging the Government of Japan to take measures to boost the number of patent lawyers and expand their scope of permitted services in order to improve the use of intellectual property in Japan. Based on the panel's recommendations, the JPO plans to submit a bill to the Diet in 2000. The United States is encouraged by these steps which, if implemented, would further strengthen the level of patent protection in Japan. We will continue to urge Japan to implement these provisions and enforce its patent laws.

Copyrights

Japan has made progress in combating computer software piracy in recent years, with the "piracy rate," as calculated by U.S. industry, falling from roughly 50 percent (of software in use) in 1994 to roughly 30 percent in 1997. The United

States continues to urge Japan to reduce the piracy rate further. A notable step toward creating an effective deterrent against piracy would be the amendment of Japan's Civil Procedures Act to award punitive damages rather than actual damages, and to provide for more effective procedures for the collection of evidence. In addition, in order to lead the private sector by example, we urge Japan to issue a policy statement clarifying Japan's commitment to use only legitimately produced and licensed software in its government's operations.

In March 1997, Japan amended its copyright law to protect sound recordings produced in the United States and other WTO countries within the past 50 years. This represented the resolution of the first intellectual property dispute settlement case at the WTO, which the United States initiated against Japan in 1996 after Japan failed to provide full "retroactive" protection to pre-existing sound recordings in accordance with the TRIPS (Trade-Related Aspects of Intellectual Property Rights) Agreement. The United States expects similar resolution of piracy over digital networks, including digital music broadcasting services. Japan also has acceded to the World Intellectual Property Organization (WIPO) Copyright Treaty and the Performances and Phonograms Treaty. When ratified, these agreements will provide new protection for producers and performers of material transmitted over the Internet.

In preparation for Japan's ratification of the WIPO Copyright Treaty expected in 2000, the Diet revised some aspects of Japan's copyright law in 1999. Key provisions of the revised law include criminal penalties for producing and distributing devices designed to circumvent copyrights, and for illegally revising copyright management information to make a profit. The United States is concerned that the penalties for copyright circumvention devices will be seldom applied since the law covers only devices whose sole purpose is circumvention. The law also expands the coverage of screening rights from motion pictures to still pictures and sets transfer rights so that the first sale doctrine covers films, books, and CDs.

Some groups in the United States have raised concerns about Japan's practices with respect to the degree of copyright protection accorded to musical compositions. It appears that Japanese authorities are applying inflexible, formalistic rules to the conduct of joint authors at the time of publication that, in certain instances, result in a denial of the full term of copyright protection for their works. This practice raises questions under the Berne Convention.

Trademarks

A number of revisions to Japan's Trademark Law came into force in 1997. The revisions aimed to accelerate the granting of trademark rights, strengthen protection of well-known marks, address problems related to unused trademarks, and simplify trademark registration procedures in order to bring Japan into compliance with the Trademark Law Treaty. These measures also increase penalties for trademark infringement. Regrettably, in spite of the existence of provisions in Japan's Unfair Competition Law designed to afford greater protection to well-known marks, protection of such marks remains weak.

The Diet passed new legislation in 1999 in preparation of ratifying the Madrid Protocol early in 2000. Effective January 1, 2000 Japan began establishing a system to notify the public of trademark applications received. Effective March 14, 2000, once a trademark is issued, rightholders also will be entitled to compensation for damages for the period from application until registration of the trademark. Further, the United States welcomes Japan's improvement in the speed of its trademark registration process, with the time required to register a trademark dropping from 36 months to just over a year.

Trade Secrets

Although Japan amended its Civil Procedures Act to improve the protection of trade secrets in

Japanese courts by excluding court records containing trade secrets from public access, this legislation does not adequately address the problem. Given that Japan's Constitution prohibits closed trials, the owner of a trade secret seeking redress for misappropriation of that secret in a Japanese court is forced to disclose elements of the trade secret in seeking protection. Because of this, and the fact that court discussions of trade secrets remain open to the public with no attendant confidentiality obligation on either the parties or their attorneys, protection of trade secrets in Japan's courts will continue to be considerably weaker than in the courts of the United States and other developed countries. The United States considers this to be unacceptable and continues to urge Japan to undertake further reform in this area.

Border Enforcement

In an effort to bolster Japan's border control measures, the United States has urged Japan to improve its Customs recordation and information submission procedures to make it easier for foreign rights holders to avail themselves of protection from Japan's Customs authorities. Further, insofar as Japan provides ex-officio border enforcement of trademarks and copyrights through the Japan Customs and Tariff Bureau (JCTB), efforts should be made to enhance such enforcement through aggressive interdiction of infringing articles. In addition, the United States is concerned by the 1997 Japan Supreme Court decision to allow parallel imports of patented products and continues to monitor JCTB's implementation of this policy.

SERVICES BARRIERS

Insurance

Japan's private insurance market is one of the largest in the world, with preliminary data indicating that direct net premiums totaled $331 billion in JFY 1998. In addition, there is a large public sector provider of postal life insurance products known as *Kampo*, the National Public Health Insurance System, and a web of mutual aid societies (*Kyosai*) that provide significant amounts of insurance. As in many countries, the supervision of the private insurance market is segmented into the traditional life and non-life (property and casualty) sectors. Moreover, in Japan, there exists a so-called "third sector," covering both life and non-life products (e.g., cancer and supplementary hospitalization insurance, as well as personal accident insurance), which represents just five percent of the total market. Foreign and smaller Japanese companies have traditionally excelled in this small segment of the market, capturing some 40 percent of sales, while their share of the primary sectors historically has been well below five percent.

The United States and Japan have concluded two bilateral insurance agreements under the U.S.-Japan Economic Framework, one in October 1994 and the second in December 1996. The latter agreement became necessary after it became apparent to the United States that Japan intended to allow its insurance subsidiaries to operate in the third sector in a manner contrary to key provisions of the 1994 agreement. Due in large part to these efforts, as well as to the Administration's close monitoring of the implementation of both agreements, deregulation of Japan's insurance market has proceeded, and the once weak presence of foreign firms in the primary sectors has begun to change substantially. While maintaining their strong third sector sales, U.S. and other foreign insurance companies have rapidly expanded their share in the primary sectors in recent years, both through product development and marketing innovations, as well as direct investment.

1994 Insurance Agreement: Implemented just prior to the legislation of extensive reform of Japan's insurance industry, the October 1994 Measures on Insurance commit Japan to take a number of steps to promote deregulation of the industry. These include enhanced transparency and procedural protections; the introduction of streamlined approaches to Japan's product and rate approval system; improved licensing procedures for insurance providers; the initiation of a brokerage system; and a survey of the

industry by the Japan Fair Trade Commission (JFTC). Regarding Japan's product approval system, the Government of Japan committed to expediting and simplifying the application review process through such steps as reducing examination requirements and time periods and introducing expedited approval review systems such as "file and use" systems. The United States more recently has offered Japan several suggestions on how the current product approval and notification systems might be improved.

Related to the postal insurance system (*Kampo*), Japan confirmed in the 1994 Agreement that the "*Kampo* Law" authorizes the Ministry of Post and Telecommunications (MPT) to offer 11 basic insurance products, and that the MPT offers a total of 25 variations of these 11 products. Japan further confirmed that Diet approval is required to expand or change the insurance products or riders offered by MPT, except for limited alterations within the scope of the products or riders authorized in the Law. Related to any changes to *Kampo* offerings, Japan committed to ensuring that foreign providers in Japan are accorded meaningful and fair opportunities to be informed of, comment on, and exchange views with MPT officials.

Finally, the 1994 Agreement contains a provision related to "mutual entry" of life insurers into non-life markets and of non-life insurers into life insurance markets, designed to ensure that deregulation of the highly segmented insurance industry does not proceed largely at the expense of foreign and small- and medium-sized Japanese insurers. Specifically, Japan agreed to avoid "radical change" in the third sector until foreign, as well as small- and mid-sized Japanese insurers, were provided a reasonable period to compete in significantly deregulated primary life and non-life sectors.

1996 Insurance Agreement: The "Supplementary Measures" of December 1996 defined the scope and timing of primary sector deregulation to be undertaken by Japan's Ministry of Finance. The agreement also defines the scope of business activities of Japanese insurance subsidiaries in the third sector consistent with the commitment to avoid radical change. In December 1997, Japan agreed to bind these commitments under the WTO Financial Services Agreement.

Specifically, Japan committed under the 1996 agreement to approve applications for automobile insurance containing differentiated rates based on a range of risk criteria, such as age, gender, driving history, geography, and vehicle usage. Japan also agreed to eliminate the authority of rating organizations to set industry-wide rates for automobile and fire insurance. In addition, Japan undertook to expand the list of products to be included under its "notification system," and phase in a reduction in the threshold above which insurers were permitted to offer flexible rates for commercial fire insurance to a seven billion yen ceiling by April 1998.

With respect to the third sector, the 1996 Agreement committed Japan to prohibit or substantially limit Japanese insurers' new subsidiaries from marketing certain third sector products of particular importance to foreign insurers, such as cancer, hospitalization, and personal accident insurance, until foreign firms had sufficient time to establish a presence in the deregulated primary sectors.

The agreement stipulated that, should Japan fully implement all of the primary sector deregulation measures contained in the 1996 Agreement by July 1998, a two-and-one-half year "clock" would begin regarding termination of the measures to avoid radical change in the third sector. The United States and Japan have not yet come to a final, joint decision as to whether or not all of the 1996 primary sector deregulation requirements have been implemented.

The most recent bilateral consultations under the two insurance agreements were held in Washington in April 1999. This was the first formal bilateral consultation involving representatives from the Financial Supervisory Agency (FSA), an independent regulatory body established in June 1998 to oversee and regulate

financial services, including insurance. In order to facilitate mutual understanding of current and future plans related to the U.S. and Japanese insurance regulatory systems, the United States included a component for regulator-to-regulator discussions during the April meetings, with representatives from the National Association of Insurance Commissioners participating.

The review included an assessment of Japan's implementation of the provisions of the 1994 and 1996 agreements using data provided by the Government of Japan and objective criteria contained in the 1994 agreement. The United States and Japan also discussed issues related to product approval, resources and technology, the policyholder protection corporations, rating organizations, and administrative and regulatory changes in Japan's insurance sector. The United States reviewed a JFTC survey of the insurance industry published in November 1998, which found the industry – then in the throes of the initial stages of deregulation – largely free of restraints on competition. The United States noted, however, that the survey overlooked the role of "case agents" in the buying practices of employees of *keiretsu* firms, and urged the JFTC to devote sufficient resources toward ensuring that large Japanese insurance firms do not abuse *keiretsu* relationships and refrain from the use of other business practices that impede competition. The United States also urged the JFTC to closely monitor the reformed non-life rating organizations to prevent any revival of cartel-like behavior among member firms.

In addition, the United States raised concerns about potential "radical change" occurring in the third sector, such as sales practices involving Group Personal Accidental insurance, and other sales of certain products by Japanese firms. Finally, the United States noted continued industry apprehension related to the FSA's ability to meet the 90-day turnaround for product approvals mandated in the agreement, and explored whether Japan could make key changes to its product approval system to enable it to operate effectively in the increasingly deregulated insurance environment.

The United States remains concerned about several aspects of Japan's administration of the insurance sector. Foreign firms have frequently encountered a lack of transparency related to important actions taken by Japan in this sector, most recently in December 1999 when it initiated a rapid process to increase the financial resources and authority of the life insurance policyholder protection corporation with minimal consultation with the insurance industry. Similarly, a lack of transparency is evident in the approval process for new insurance products and rates. Foreign insurance providers have noted that the criteria used by the FSA to make product approval decisions are minimal, vague and potentially arbitrary. Firms also have reported that when requested by the FSA to provide additional information to support product applications, FSA officials have been reluctant to provide those requests in writing.

In its October 1999 deregulation submission to Japan under the Enhanced Initiative, the United States included an expanded list of requests related to insurance to address these concerns. Specifically, the United States requested that the FSA undertake further efforts to conduct all communications with the companies it regulates in a fair and transparent manner, as called for in the Administrative Procedures Law (APL); that the Japanese Government significantly increase FSA staff and in-house technical expertise; and that Japan adopt a modernized and a stream-lined product approval system. The United States also expressed serious concerns with potential Japanese plans to expand the role of the government postal insurance system (*Kampo*). The United States pointed out that any expansion of *Kampo* into product lines being offered by private insurers is inconsistent with Japan's goals of deregulation and "Big Bang" market reforms. The United States also expressed concern that *Kampo* falls outside the scope of the Insurance Business Law and is not subject to oversight by the FSA or the JFTC. These items were discussed during a meeting of the deregulation structural working group in November 1999 and February 2000, at which time the United States emphasized that Japan's

adoption of these requests would be a key step toward moving forward on our insurance agenda with Japan.

The deregulatory steps taken to date by Japan in accordance with the 1994 and 1996 bilateral Insurance Agreements have yielded important results. Several major U.S. and other foreign insurance companies have entered the market in the past two years, the foreign presence in the market has grown significantly, and rate and product competition have increased. Concerns remain, however, and the United States continues to seek to resolve outstanding issues with Japan, and to insist upon full and faithful implementation of the commitments made under the 1994 and 1996 bilateral Insurance Agreements.

Professional Services

The Administration continues to seek improved access for professional service providers in Japan through our bilateral public works agreements for construction, architectural, and engineering services; under the Enhanced Initiative for legal services; and in the WTO for accounting and auditing services.

The ability of foreign firms and individuals to provide professional services in Japan is hampered by a complex network of legal, regulatory and commercial practice barriers. U.S. professional services providers are highly competitive and the United States expects the export of such services to continue to grow. These services are important, not only as U.S. exports, but as vehicles to facilitate access for U.S. exporters of other services and goods to the Japanese market. Moreover, U.S. services professionals often can contribute valuable expertise gained from broad experience in international markets and stimulate innovations for the economies in which they serve.

Through the WTO Working Party on Professional Services, WTO members have developed disciplines on the regulation of the accountancy sector to make it easier for accountants to provide their services on a cross-border basis or in other countries. The disciplines, adopted by the WTO in December 1998, are scheduled to become effective after the next round of negotiations. The GATS negotiations also provide an opportunity for further negotiation to liberalize accountancy and other professional services.

Accounting and Auditing Services: U.S. providers of accounting and auditing services face a series of regulatory and market access barriers in Japan which impede their ability to serve this important market. In Japan, regulated accounting services may be provided only by individuals qualified as Certified Public Accountants (CPAs) under Japanese law, or by an Audit Corporation (composed of five or more partners who are Japanese CPAs). To become qualified as a CPA in Japan, a foreign accountant must pass a special examination for foreigners in order to obtain a professional certification. This examination was last offered in 1975. CPAs in Japan must also be registered as members of the Japanese Institute of Certified Public Accountants and pay membership fees.

Only individuals who are Japanese CPAs can establish, own, or serve as directors of Audit Corporations. An Audit Corporation may employ foreign CPAs as staff, but foreign CPAs are not allowed to conduct audit activities. Furthermore, an Audit Corporation may engage in a partnership/association relationship with foreign CPAs only if the partnership/association does not provide audit services. Audit Corporations are prohibited from providing tax-related services, although the same individual may perform both functions as long as totally separate offices are maintained. Establishment is required for Audit Corporations, but not for firms supplying accountancy services other than audits.

Branches and subsidiaries of foreign firms, however, are not authorized to provide regulated accounting services. Nor can a foreign firm practice under its internationally recognized name; its official firm name must be in Japanese and is subject to approval by the Japanese Institute of Certified Public Accountants. The

United States will continue to urge Japan to open this restrictive market.

Legal Services: U.S. lawyers have sought greater access to Japan's legal services market and full freedom of association with Japanese lawyers (*bengoshi*) since the 1970s. However, strong opposition from the Japan Federation of Bar Associations (*Nichibenren*) and a reluctant Japanese bureaucracy have largely thwarted this objective.

Since 1987, Japan has allowed foreign lawyers to establish offices and advise on matters concerning the law of their home jurisdictions in Japan as foreign legal consultants (*gaikokuho-jimu-bengoshi* or *gaiben*), subject to restrictions in the Special Measures Law Concerning the Handling of Legal Business by Foreign Lawyers (Law No. 66 of 1986, as amended) (Foreign Lawyers Law). Since this Law was enacted, Japan has liberalized several restrictions on foreign lawyers, including: (1) allowing foreign lawyers to represent parties in international arbitrations in Japan; (2) reducing the experience required to register as a foreign legal consultant from five years to three years; and (3) allowing foreign lawyers to count the time spent practicing the law of the lawyer's home jurisdiction in a third country toward meeting the three-year experience requirement. However, Japan has adamantly refused to remove the most restrictive regulatory hurdle facing foreign lawyers in that country – the ban on hiring or forming partnerships with Japanese lawyers in Japan.

In its October 1999 submission to Japan under the Enhanced Initiative, the United States stressed the need for Japan's legal service infrastructure to be capable of meeting the needs of Japanese and foreign persons and enterprises that are responding to the opportunities created by market liberalization and deregulation. The United States pointed out that Japan's restructuring process, e.g., in the financial services sector, will be seriously impeded if Japan continues to thwart the development of a globally competitive legal services sector in Japan. Both Japanese and foreign persons and enterprises must be able to obtain fully integrated transnational legal services for domestic and cross-border transactions.

Rather than allow Japanese attorneys and foreign lawyers to form full partnerships, as is the common practice in most other countries, Japan in 1995 created, through an amendment to the Foreign Lawyers Law, an arrangement that is unique to Japan – "specified joint enterprises" (*tokutei kyodo jigyo*) between Japanese attorneys and foreign lawyers. Despite an expansion in 1998 of the scope of work that may be undertaken by the enterprises, only a handful of foreign firms have created joint enterprises. Even those that have formed joint enterprises have faced difficulties.

The United States has made the removal of the ban on partnerships and employment a top priority, arguing that Japan should allow foreign lawyers and *bengoshi* to determine on their own the most appropriate form of association that will enable them to best serve their clients' needs. The United States also has stressed that the joint enterprise system does not serve as an adequate substitute for partnerships, nor can the system be adjusted to overcome its inherent defects.

In December 1999, the Government of Japan's Regulatory Reform Committee, in a report approved by the Cabinet, stated that "we cannot find any rational reason to prohibit employment of Japanese lawyers by foreign legal consultants," and recommended that over the short run, Japan should take steps, such as a review of regulations defining the purposes of the designated joint enterprise, to "enable foreign legal consultants and Japanese lawyers to provide legal services for any type of issues based upon a complete and comprehensive cooperative relationship." In spite of this policy directive, the Ministry of Justice in January 2000 only stated that it would "examin[e] if further improvement could be made on the joint enterprise system."

Also in 1999 under the Enhanced Initiative, the United States requested that Japan ensure that

foreign lawyers have meaningful opportunities to participate in the development by the *Nichibenren* and mandatory local bar associations of all new or amended rules or regulations that affect them. In particular, the United States recommended that Japan: (1) require the *Nichibenren* and local bars to provide for greater representation and effective participation by foreign lawyers on all *Nichibenren* and local bar committees that consider registration, discipline and all other regulations and issues relevant to foreign lawyers; (2) require the *Nichibenren* and local bars to use public comment procedures before adopting or issuing rules or regulations; (3) reduce the time required for registration by foreign lawyers; and (4) ensure that the *Nichibenren* and local bars do not impose any restrictions on the joint enterprises.

In its October 1999 submission, the United States also requested that Japan allow a foreign lawyer full credit for experience in Japan toward the three-year experience requirement to register as a foreign legal consultant, and not just the one year allowed under current practice. The Ministry of Justice refuses to acknowledge the lack of rational basis for this practice, which renders experience in Japan less valuable than that gained in any other country.

The United States has also sought the removal of restrictions on foreign lawyers providing advice on so-called "third country" law (that is, the law of a country other than the one which is a foreign lawyer's home jurisdiction). The United States also recommended that Japan increase the number of trainees admitted to the Japanese Supreme Court's Legal Research and Training Institute to no less than 1,500 trainees annually as soon as possible, but no later than April 1, 2000, and explore alternative ways of obtaining legal qualification outside the Institute. As of the beginning of 2000, the number of trainees had been increased to 1,000 per year, and the Ministry of Justice is considering further increases.

The United States continues to urge Japan to remove the ban on partnerships and employment, make the regulation of foreign lawyers more transparent, and eliminate other unnecessary and unreasonable restrictions on legal services in Japan.

INVESTMENT BARRIERS

Despite its status as the world's second largest economy, Japan continues to have the lowest inward foreign investment as a proportion of total output of any major OECD nation. In JFY 1998, for example, Japan's annual inward foreign direct investment (FDI) totaled $10.5 billion, or only 0.27 percent of its GDP. Nonetheless, FDI in Japan is rising rapidly, albeit from a small base, up 89.4 percent in JFY 1998 from the previous year's level. In the first half of JFY 1999, FDI rose 166 percent as compared to the same period in JFY 1998 to $11.33 billion, boosted by sizeable investments in Japan's autos and telecommunications sectors. Japan's outward investment flows continue to dwarf investment into Japan, but the gap between outward-to-inward FDI is narrowing. The ratio averaged 11-to-1 between 1990 and 1996, shrinking to 3.9-to-1 in JFY 1998. Based on figures released by the Ministry of Finance, Japan's FDI outflow fell 24.5 percent from the previous year to $40.74 billion in JFY 1998. Foreign participation in the field of mergers and acquisitions (M&As) also lags in Japan, as compared to other OECD countries, although there is an upward trend. From January to September of 1999, 826 cases of M&A were recorded, up 22.6 percent from the previous year.

Acknowledging that Japan's inward investment lags far behind that of other industrialized economies, Japan has taken some actions with the aim of creating a more attractive environment for FDI in Japan. In 1994, Japan established the Japan Investment Council (JIC), chaired by the Prime Minister and charged with promoting measures to improve Japan's investment climate, coordinating policies of ministries and agencies concerned with investment, and disseminating information on investment-promotion measures. The JIC has released periodically policy statements that

encouraged FDI and listed policy recommendations. In April 1999, the JIC produced an Expert Committee Report on "Seven Recommendations for Promoting Foreign Direct Investment in Japan," which included advocating deregulation and additional steps to facilitate M&As.

Although most direct legal restrictions on FDI have been eliminated, bureaucratic obstacles remain, including the occasional discriminatory use of bureaucratic discretion. While Japan's foreign exchange laws currently require only ex-post notification of planned investment in most cases, a number of sectors (e.g. agriculture, mining, forestry, fishing) still require prior notification to government ministries. More than government-related obstacles, however, Japan's low level of inward FDI flows reflects the impact of exclusionary business practices and high market entry costs.

Difficulty in acquiring existing Japanese firms – as well as doubts about whether such firms, once acquired, can continue normal business patterns with other Japanese companies – make investment access through mergers and acquisitions more difficult in Japan than in other countries. However, the pressure of economic restructuring and the surge in M&As to a degree have weakened *keiretsu* relationships. U.S. investors cite the lack of financial transparency and disclosure and differing management techniques among the obstacles to realizing M&As in Japan. Extensive cross-shareholding among allied companies and difficulties foreign firms encounter in hiring employees also inhibit foreign direct investment.

In July 1995, the United States and Japan concluded an arrangement entitled "Policies and Measures Regarding Inward Direct Investment and Buyer-Supplier Relationships" that lays out the inward FDI promotion policies instituted by Japan during the course of the Framework Agreement investment negotiations. The arrangement committed Japan to expand efforts to inform foreign firms about FDI-related financial and tax incentives and broaden lending and eligibility criteria under these programs; make low interest loans and tax incentives under the 1992 Inward Investment Law available to foreign investors; propose measures to improve the climate for foreign participation in M&As; and strengthen the FDI promotion roles of the JIC, Office of Trade and Investment Ombudsman, JETRO, and the Foreign Investment in Japan Development Corporation.

The Inward Investment Law has been extended from May 1996 to May 2006. In addition, MITI has lowered the interest rate charged by the Japan Development Bank to foreign investors in high technology projects. In April 1996, foreign firms' eligibility for tax incentives was extended from the first five years to the first eight years of operation of a foreign firm in Japan. Looked at in their totality, however, Japan's FDI promotion policies are mostly appendages to domestic-oriented investment-promotion programs, and do not appear significant enough to immediately overcome the continuing fact that foreign investment levels in Japan remain low.

After the signing of the Investment Arrangement, the bilateral discussions of the Investment Working Group have focused more broadly on needed changes in the basic operating rules of Japanese markets, in order to encourage policy changes that will help improve Japan's overall environment for foreign (and domestic) investment. More specifically, the United States has urged Japan to consider measures that will assist with three key aspects of improving Japan's direct investment environment, including: (1) developing a more active and efficient market for M&As in order to enhance the productivity of capital in Japan; (2) improving land market liquidity and foreign investors' access to land; and (3) increasing the flexibility of Japan's labor markets.

In July 1998, the Investment Working Group agreed to compile a follow-up report to the 1995 Investment Arrangement, which would focus on needed policy changes in these three areas. As part of that process, in October 1998 the United States offered specific proposals for areas where policy changes appear most likely to lead to

significant improvement in Japan's investment environment.

In the area of mergers and acquisitions, U.S. proposals included: allowing consolidated taxation in order to spur investment by lowering the post-tax cost to a parent firm of investing in new risk ventures; taking steps to unwind extensive cross-shareholding in Japan; improving corporate governance practices in order to mitigate senior management emphasis on firm loyalty over shareholder return, which can lead to premature rejection of M&A offers; continuing with financial market deregulation, such as allowing stock-for-stock transactions and easing stock market listing requirements; improving financial data disclosure to assist firms interested in pursuing M&A relationships with other firms; increasing the availability of M&A-related services, including further easing of restrictions governing the accounting and legal professions; and introducing smoother and more flexible bankruptcy procedures to make it easier for a corporation and its assets to be acquired or merged in a "rescue" format.

U.S. proposals addressing land and real estate transactions focused on improving land market liquidity, and included undertaking additional land tax relief measures and steps to further shift the burden of land taxation from acquisition taxes to holding taxes; easing regulations on developing property in central urban districts as well as relaxing restrictions on the conversion of agricultural land; changing leasing rules to allow new investors to make flexible use of acquired property; making systematic disclosure of information on real estate transactions; and making changes to the Special Purpose Corporation (SPC) Law and other related regulations to facilitate the creation of real estate investment trusts (REITs).

Finally, the United States stressed the need to improve labor mobility in Japan, recommending that Japan introduce defined contribution pension plans as a useful way to improve pension portability; deregulate fee-charging employment agencies in order to assist foreign investors in locating needed local talent; liberalize Japan's labor dispatching business in order to help new investors find workers and cut costs, as well as help unemployed workers find work; and ease excessively tight regulations concerning work rules, as well as other bureaucratic procedures which unnecessarily raise costs and lower the efficiency of corporate operations.

At the May 1999 U.S.-Japan Summit, the Investment Working Group presented to the President and Prime Minister the "Report to the President and Prime Minister on the Environment for Foreign Investment in Japan and the United States." The report reviewed key issues and the progress the Government of Japan has made in improving Japan's investment climate. The report also committed the two Governments to continue to exchange information and consult on investment matters.

In the months since the report was submitted, Japan has enacted new and revised legislation which will provide opportunities for foreign investors in the M&A field, including the Industrial Revitalization Law, which provides existing firms undergoing reorganization (both domestic and joint-venture) with tax and credit relief once the firm's business restructuring plan is approved by the Government. A new bankruptcy law (the Civil Reconstruction Law) also may provide investment opportunities as it encourages business reorganization, including spin-offs, rather than forced liquidation of assets. Other legislative changes now provide for stock-for-stock swaps, a major vehicle for M&As, as well as stock options for employees, a key issue for foreign firms wishing to attract high quality employees. In addition, the Government of Japan is preparing legislation on corporate divestiture which will facilitate companies' streamlining efforts. While U.S. businesses have applauded these changes, they continue to urge that Japan's tax regulations be amended to facilitate use of these measures.

In October 1999, the Investment Working Group met to review outstanding issues and evaluate progress made by Japan in improving inward investment flows. Based on these discussions,

the United States and Japan held a joint conference on FDI and M&As in Japan on March 1, 2000 with active participation from the private sector and relevant Japanese ministries. An audience of about 560 U.S. and Japanese business representatives provided convergent views and detailed suggestions on the need for Japan to increase corporate governance and regulatory transparency, improve accounting and disclosure standards and improve real estate liquidity and labor mobility as means of facilitating both domestic and foreign investment. Both business communities also called for the early introduction of consolidated corporate taxation to assist in spin-offs and new acquisitions.

ANTI-COMPETITIVE PRACTICES

Anti-competitive practices are a crosscutting issue in U.S.-Japan trade relations. In addition to this section, there is further discussion related to anti-competitive practices and Antimonopoly Law (AML) enforcement in several other sections, particularly under the Enhanced Initiative and Flat Glass.

Exclusionary Business Practices: U.S. firms trying to enter or participate in the Japanese market face a host of exclusionary Japanese business practices that block market access opportunities. These include:

< Anti-competitive private practices – such as bid-rigging, price-fixing, and exclusive dealing arrangements – that violate the AML but often go unpunished;

< Corporate alliances and exclusive buyer-supplier networks, often involving companies belonging to the same business grouping (*keiretsu*);

< Corporate practices that inhibit foreign direct investment and foreign acquisitions of Japanese firms (e.g., non-transparent accounting and financial disclosure, high levels of cross-shareholding among *keiretsu* member firms, low percentage of publicly traded common stock relative to total capital in many companies, and the general absence of external directors); and

< Industry associations and other business organizations that develop and enforce industry-specific rules limiting or regulating, among other things, fees, commissions, rebates, advertising, and labeling for the purpose of maintaining "orderly competition" among their members, and often among non-members.

Exclusionary business practices exact a heavy toll on the Japanese economy. For example, many products and services cost substantially more – often by multiples of two or greater – in Tokyo than in other international cities. By constraining market mechanisms, exclusionary business practices reduce the choices available to businesses and consumers, and raise the cost of goods and services. In addition, by discouraging competitors who seek to break into Japan's market with innovative products and services, the practices impede the development of new domestic industries and technologies. Such practices discourage potential foreign investors, whose market presence and technological innovation would stimulate the economy and provide critical channels for exports and sales by foreign firms.

JFTC's Enforcement Record: A key reason for the prevalence of anti-competitive business practices is the historically weak antitrust enforcement record of the Japan Fair Trade Commission (JFTC). The JFTC routinely has faced domestic criticism for its lack of bureaucratic clout and inability to exercise its enforcement powers aggressively. There have been improvements in recent years due to sustained U.S. efforts under the Structural Impediments Initiative, the U.S.-Japan Framework Agreement, the Enhanced Initiative, and annual bilateral antitrust consultations, which all have combined to help the JFTC muster domestic support for its gradual strengthening. Nonetheless, the JFTC's

enforcement efforts fall short of those needed to ensure that Japanese markets are open to competition from U.S. and other foreign firms.

While the JFTC's record in terms of actions taken against, and surcharges collected from, violators of the AML has increased in recent years, the JFTC faces serious constraints in building an effective enforcement program. For example, in 1998 the JFTC took legal measures in 27 cases, and the total amount of administrative surcharges was 3.14 billion yen. Still, these totals remain modest in absolute terms, and Japan recently enacted legislation to expand the number of small- and medium-sized enterprises that will face reduced surcharges should they violate the AML in the future. Further, the JFTC has no flexibility to reduce or eliminate surcharges for companies that come forward to expose illegal activities. The United States has suggested that the JFTC consider adopting a program such as the U.S. Department of Justice's Corporate Amnesty Program that has proven very effective in the uncovering and prosecution of cartels.

Similarly, while the JFTC is not alone among competition agencies in the world that rely heavily on administrative actions instead of criminal penalties, the JFTC's infrequent use of the Antimonopoly Act's criminal provisions undermines its deterrence of cartel behavior. Further, no corporate executive has ever been imprisoned for violating the AML. Still, the JFTC initiated two criminal prosecutions of Antimonopoly Law violations in 1999, the most in any single year.

There are at least two reasons for the limited prosecution of criminal violations. First, the JFTC does not have the types of investigatory powers enjoyed by other Japanese criminal investigating authorities, including the power to conduct compulsory searches and seizures, or to conduct interrogations. This weakness makes it difficult for the JFTC to gather enough evidence to support filing a criminal matter with the Ministry of Justice. Second, if, after receiving a criminal referral from the JFTC, the Ministry of Justice decides that there is not enough evidence to warrant prosecution, it must report its decision of nonprosecution to the Prime Minister's Office. This extraordinary procedural requirement makes Ministry of Justice prosecutors demand that the JFTC support its criminal accusation with highly compelling evidence to ensure that they will never have to make a report of nonprosecution to the Prime Minister's Office. These types of systemic weaknesses make criminal prosecution of executives and firms, e.g. for such activities as cartel behavior, the exception rather than the rule in Japan.

In addition to the problems raised under the Enhanced Initiative concerning JFTC staffing and future reorganization, observers have also raised concerns regarding the JFTC's institutional independence. Nevertheless, recent changes among the line-up of commissioners suggest an effort is being made to address this concern. The current JFTC Chairman is a former public prosecutor and ex-official (Ministry of Justice) who has raised some public expectations of a more activist JFTC enforcement role. In 1999, upon the retirement of a commissioner who had spent most of his career as a bureaucrat at MITI, a professor and former senior director at a major electronics firm was chosen as his successor.

Laws Distorting Competition

The JFTC administers or helps administer a number of laws and regulations that distort competition and often have anti-competitive effects.

Law Against Unjustified Premiums and Misleading Representations: The JFTC imposes overly restrictive limits on the use of premium offers (prizes) and other sales promotion techniques, and thereby discourages even legitimate cash lotteries and product giveaways used in such promotions. Foreign newcomers, who depend on innovative sales techniques to market their company names and products, are significantly impaired by the JFTC's restrictions on premiums. In addition, although the law aims to deter misleading or fraudulent

advertising and labeling (itself a worthy policy), the JFTC allows "fair trade associations" (essentially, private trade associations) to set their own promotion, advertising and labeling standards through self-imposed "fair competition codes." Trade associations can, and often do, use the cover of these codes to set additional standards that are stricter than the JFTC regulations under the Premiums Law. The United States continues to urge Japan to review the necessity of §10-5 of the Premiums and Misrepresentations Law, which provides an exemption for fair trade associations from the AML, with a view towards abolishing that provision.

As of January 2000, there are 48 JFTC-authorized private premium codes. In April 1996, the JFTC incrementally liberalized its rules on premiums and other sales promotions, for example, by raising the maximum value of "open" cash lotteries (not requiring a purchase) to 10 million yen; repealing restrictions on premiums offered by department stores; and eliminating the 50,000 yen ceiling on consumer premiums (while retaining price caps as a percentage of the transaction value). Moreover, over the last two years, the JFTC abolished 24 of 29 industry-specific premium limits. The five industries that remain subject to stricter rules are real estate, household electrical appliances, newspapers, magazines, and hospital management. However, the JFTC changes fall short of the dramatic, pro-competitive liberalization measures requested by the United States in Framework discussions and under the Enhanced Initiative.

Resale Price Maintenance: In April 1997, Japan abolished all product exemptions of the AML, with the prominent exception of copyrighted products (books, magazines, newspapers, and CDs). There is no reason that retail price maintenance should be treated any differently under the AML than any other practice. The JFTC has been considering limiting or eliminating the retail price maintenance exemption for copyrighted products. On January 13, 1998, a study group to the JFTC recommended a phased elimination of this exemption, and the JFTC announced its decision on March 31, 1998, which stated:

- Even though the resale price maintenance exemption should be abolished from the viewpoint of competition policy, the issue should be further examined by carefully considering cultural impacts and influences;

- Until the final decision is made, application of the exemption is limited to books, magazines, newspapers, music CDs, cassettes and records; and

- The relevant industries should therefore make determined efforts to reduce the adverse effects of this system.

Relationship between Government and Industry

Japanese regulators view their role not simply as neutral arbiters of a legal rule-based system, but as active players in guiding the respective industries under their purview. The close government-industry relationship in Japan often works to the disadvantage of foreign firms trying to enter or participate in the Japanese market because the relationship favors domestic firms. Several aspects of the relationship are of particular concern, including:

Private Regulations: The United States has emphasized that as Japan removes and relaxes regulations, it is essential that industry associations and other private sector organizations are not allowed to substitute private sector regulations (so-called "*min-min kisei*") in their place. Private regulations, including rules on market entry and business operations, approvals, standards, qualifications, inspections, examinations and certification systems can adversely affect business activities. One of the particular concerns raised by the United States under the Enhanced Initiative is the Government of Japan's formal or informal delegation of governmental or public policy functions, such as industry standard

development, product certifications and entry authorizations, to industry associations and other business-related organizations. Unfortunately, these groups are generally not under an obligation to conduct their deliberations in an open, transparent and non-discriminatory manner, or to include foreign firms in their discussions. The United States has asked Japan to refrain from delegating out such government or public policy functions. If there is a demonstrated need for such a delegation of authority, the United States wants to ensure that it is carried out by the associations in an open, transparent and non-discriminatory manner and does not restrict the business activities of firms that are not members of the association.

Informal Management of Industry: Business in Japan is more heavily regulated than in the United States. Much regulation takes place privately and informally through a variety of means: cooperative consultations between a ministry or agency and the affected industry, industry association or other business-related organization; the issuance of "administrative guidance" to companies; and the placement of retired bureaucrats in companies and industry associations through a practice called *amakudari* (literally, "descent from heaven").

ELECTRONIC COMMERCE

As the second largest economy in the world and the nation with the second largest electronics industry in the world after the United States, Japan is an important market for electronic commerce and a key player in international discussions regarding the regulatory framework for global electronic commerce and the Internet. The United States is pleased to see that Japan has, in its policy statements and its regulatory actions to date, endorsed an open, private sector-led and minimally regulated environment for the Internet and electronic commerce. Nonetheless, the development of both the Internet and electronic commerce lags in Japan compared with other developed countries, with only about 11 percent of Japanese homes connected to the Internet in 1999, compared to roughly 37 percent in the United States. While the number of Internet users in Japan is on the rise, the United States continues to work with Japan to ensure robust growth in this critical sector, specifically by targeting the high cost of accessing the Internet in Japan. Such charges, estimated by the OECD to be double that of the United States, New Zealand, and Canada and four times more expensive than in Korea, are a result of the market access barriers to Japan's telecommunications sector (see "Sectoral Deregulation" section of this chapter), and are currently being addressed by the United States and Japan under the Enhanced Initiative.

Following the announcement by President Clinton of the "Framework for Global Electronic Commerce" policy paper in July 1997, the United States entered into discussions with Japan on a range of electronic commerce issues from that paper. In May 1998, at the Birmingham Summit, President Clinton and then-Prime Minister Hashimoto announced the "U.S.-Japan Joint Statement on Electronic Commerce." In the Joint Statement, the United States and Japan agreed that: (1) the private sector should lead in the development of electronic commerce; (2) governments should encourage industry self-regulation; (3) government regulation, where necessary, should be minimal, transparent, and predictable; and (4) regulatory frameworks for electronic commerce should be developed on a global basis, rather than nation by nation.

With respect to several specific policy issues, the Joint Statement noted that: (1) privacy, and the protection of confidential consumer data, should be protected through industry self-regulation, with industries responsible for drafting guidelines, enforcement mechanisms, and recourse methodologies; (2) tariffs should not be imposed on electronic transmissions and the United States and Japan will work toward a global understanding in the WTO to preserve a duty-free environment for electronic transmissions; (3) content should be transmitted freely across national borders in response to a user's request; (4) electronic authentication/electronic signatures will be necessary to enforce contracts on the Internet;

(5) the United States and Japan support the development of a variety of implementation methods and technologies, led by the private sector; and (6) tax treatment of electronic commerce should be addressed through the on-going discussions at the OECD.

These principles were echoed in a June 1998 policy paper issued by the Advanced Information and Telecommunications Society Promotion Headquarters, an advisory group to the Prime Minister. While supporting these general principles, Japan has also been working on specific policy areas, including the planned introduction of a new bill in the Spring of 2000 to give electronic authentication equivalent legal status to traditional handwritten signatures and personal seals. The Ministries of International Trade and Industry, Posts and Telecommunications, and Justice jointly published a draft policy on electronic authentication for comment in November 1999, and the National Police Agency (NPA) published its own draft policy in the same month. In their comments, U.S. industry representatives urged that any policy chosen by Japan contain no government-sanctioned accreditation requirement and that Japan continue to work with other governments to harmonize legal frameworks. Regarding the NPA draft, industry expressed concern that it was overly restrictive and would be counterproductive. The United States will be closely monitoring the progress of this legislation.

The United States will continue to work with Japan on these and other electronic commerce issues (e.g., intellectual property protection on the Internet, consumer protection, and electronic payment systems) and to monitor the development of electronic commerce and the Internet in Japan to ensure that Japanese Government-funded test-bed projects for electronic commerce continue to be fully open to participation by U.S. firms and that standards and technologies for electronic commerce and the Internet remain open and internationally interoperable. The United States will also monitor actions by regulators such as MPT (e.g. regarding licensing requirements and restrictions on new standards and technologies) to ensure that the most liberal regime possible is promoted.

OTHER BARRIERS

Aerospace

Japan is the largest foreign market for U.S. aircraft and aerospace products, and many Japanese firms have entered into long-term and productive relationships with American aerospace firms. Nonetheless, the United States is continuing to closely monitor several aspects of U.S.-Japan aerospace trade.

Among these are the Japan Defense Agency's general preference for licensing foreign technology for production in Japan, which has resulted in lower U.S. defense aerospace exports than would occur in a more market-driven environment. With respect to commercial aerospace, the United States is monitoring MITI's active role in supporting the domestic aerospace industry, funding feasibility studies for new projects and technologies, and the important role it plays in the apportioning of work among the major Japanese aerospace companies. We also are closely watching the role that the Japan Defense Agency plays in the development of defense aerospace projects, which have resulted in a significant transfer of U.S. aerospace technology to Japan and positioned Japan to become a major supplier of parts and components to foreign aircraft assemblers.

With respect to space systems, the United States is monitoring Japan's efforts to develop indigenous systems, which may limit the procurement of proven U.S. technology and products. The United States will continue to push for greater access to areas where Japan's preference for the development of domestic space technologies has been most pronounced, including: space recorders and scientific instruments; sensors for earth resources and astronomical research satellites; and software

and ground-based data processing, storage and distribution systems.

The United States will continue to monitor developments to ensure that the Japanese aerospace market remains open and that Japanese Government actions do not discriminate against U.S. aerospace firms.

Autos and Auto Parts

The 1995 U.S.-Japan Automotive Agreement seeks to eliminate market access barriers and significantly expand sales opportunities in this sector. Under the agreement, Japan committed to improve access for foreign vehicle manufacturers, expand opportunities for U.S. original equipment parts manufacturers in Japan and the United States, and eliminate regulations that restrict access for U.S. and other competitive foreign automotive parts suppliers to Japan's repair market. The agreement includes 17 objective criteria by which the United States and Japan are to evaluate progress. Coincident with the conclusion of the agreement, the five major Japanese auto manufacturers announced plans to increase purchases of foreign auto parts in Japan and expand production of vehicles and major components in the United States.

The Administration attaches high priority to vigorous implementation of the Automotive Agreement given this sector's importance to the U.S. economy. To monitor implementation and assess progress achieved under the agreement, an Interagency Enforcement Team, headed by the Office of the U.S. Trade Representative and the Department of Commerce, was established. This team prepares a semi-annual report evaluating progress since the agreement was reached. The sixth and most recent of these reports was issued in June 1999.

Although results in some areas have been satisfactory, the United States remains concerned about the lack of progress toward achieving the agreement's key objectives. The United States conveyed specific concerns to Japan during the fourth annual review of the Automotive Agreement held in Vancouver, British Columbia in October 1999, and its concerns were echoed by representatives from the European Union, Canada, and Australia. The United States called upon Japan to take additional, concrete actions to ensure continuing improvements in market access and sales opportunities in the Japanese automotive market and urged immediate, substantial deregulatory and market-opening action to foster domestic demand-led growth. The United States followed up on these requests during informal meetings held in November 1999.

Vehicles: Sales in Japan of motor vehicles produced by DaimlerChrysler, Ford, and General Motors continued to decline in 1999, with their combined sales falling 19.7 percent as compared to 1998 sales. This decline came on the heels of back-to-back year-on-year declines of 34.5 percent in 1998 and 20 percent in 1997. The drop in DaimlerChrysler, Ford, and General Motors exports in 1999 well-exceeded the 0.31 percent contraction of the overall Japanese auto market in 1999. Structural reforms in the automotive industry have led U.S. companies to alter their sales and distribution strategies in Japan. Nonetheless, foreign access to Japan's automotive distribution network remains a concern as U.S. auto companies work to strengthen their dealership networks.

Auto Parts: Exports of U.S.-made auto parts to Japan fell 11.5 percent in 1999 following a 7.5 percent decline in 1998. In contrast, from 1993 to 1997, exports of U.S.-made parts increased an average of 20 percent per year. Sales to Japan remain low, and concerns are mounting that recent declines in orders for original equipment parts will push these numbers down further still. Moreover, despite large percentage increases, actual U.S. aftermarket parts sales to Japanese auto companies in the U.S. and Japanese auto companies in Japan also remain weak.

These trends in bilateral automotive trade have raised serious concerns about progress under the agreement. To address these concerns, the United States has strongly urged Japan to undertake additional market opening and

deregulatory measures in this sector. At the annual review of the Automotive Agreement in October 1999, the United States and Japan discussed proposals made in the previous consultations as well as new proposals for achieving progress in deregulation, competition enhancement, and standards issues. To strengthen dealerships, which are key channels to the automotive distribution system, the United States proposed that Japan streamline new vehicle registration in Japan. Japan also is consulting closely with U.S. Government and industry to revise its import promotion and financial programs offered by MITI, the Japan Export-Import Bank, and the Japan Development Bank to make them more useful to foreign companies. On standards, the United States proposed that U.S.-based testing agencies be allowed to witness test Japanese requirements; that the role of the Ministry of Transport official based in Detroit be expanded; and that Japan review the need for end-of-line inspections.

In addition, the United States proposed: (1) eliminating unnecessary requirements of the "*shaken*" inspection and repair systems to allow more garages, particularly independent garages (which are more inclined to use foreign auto parts), to conduct inspections and repairs; (2) removing additional components from the disassembly repair regulations (critical parts list); (3) allowing mechanics working in specialized garages to be certified in the types of repair conducted by that garage (to allow a progression of expertise and skill in mechanic certification), which would encourage the development of specialized garages created under the agreement to encourage the development of an independent repair market; and (4) reviewing the policies regarding development and implementation of regulations to prevent Japanese trade associations and other vested interests from undermining the intended impact of deregulation. The United States also requested that Japan continue to support JETRO programs aimed at promoting imports of foreign auto parts, and that the Ministry of Transport not re-institute its proposal for establishing an auto parts recall system.

During informal consultations in February 1999, Japan informed the United States that it planned to take action to streamline the new vehicle registration system this year, including establishment of a "one-stop shop" for all new vehicle registration procedures by 2000. Japan also agreed to consult with individual U.S. and other foreign automakers on ways to adapt the import promotion programs it has established to make them more valuable to these companies. On auto parts, Japan agreed to discuss possible deregulation of the *shaken* system and informed the United States of its intention to further liberalize the certified mechanics system by creating another class of special certified mechanics, a move taken in response to U.S. requests.

Meanwhile, Japanese auto manufacturers have made considerable progress in implementing the voluntary global business plans they announced when the Automotive Agreement was signed. They have boosted production of passenger cars, light trucks, and a range of components, including engines and transmissions, in the United States. These increases have led to new sales opportunities for U.S. suppliers, and increased employment opportunities for U.S. workers. In addition, the Japanese automakers in 1999 renewed their commitment to invest in the U.S. market.

The United States will continue to closely monitor Japan's implementation of the Automotive Agreement and to press Japan at all levels to take concrete steps to achieve additional progress under the agreement. The U.S. Government also has begun consulting with U.S. industry, labor groups, and other interested parties to develop a position on what type of follow-on agreement it will seek once the current Automotive Agreement expires at the end of December 2000.

While noting that it shares Japan's environmental objectives in developing new fuel economy regulations, the United States has been discussing ways to ensure that the application and enforcement of such regulations are transparent and non-discriminatory. The United

States and Japan are seeking to reach agreement on these issues in the near future.

Civil Aviation

On March 14, 1998, Transportation Secretary Slater and then-Japanese Transport Minister Fujii signed a Memorandum of Understanding (MOU) which promised to significantly expand civil air services between the United States and Japan and set the stage for further liberalization. The agreement removed all restrictions on the U.S.-Japan services of so-called "incumbent" carriers – United Airlines, Northwest Airlines, and Federal Express for the U.S. side – that operate from any U.S. gateway point to any point in Japan and beyond Japan to third countries, without limitation on the number of flights. It also allowed the United States to designate two additional passenger carriers to serve Japan, one immediately (Trans World Airlines) and another in 2000.

Moreover, U.S. "non-incumbent" combination carriers (carriers that carry both passengers and cargo) now serving Japan – American Airlines, Delta Air Lines and Continental Airlines along with the two newcomers – can add up to 90 more weekly round-trip flights to their current total of 46, nearly tripling access to Japan's huge aviation market. Non-incumbent all-cargo carriers United Parcel Service and Polar Air Cargo gained new operational flexibility, creating valuable new opportunities to transport cargo to destinations beyond Japan. In 2002, another U.S. all-cargo carrier can enter the market.

The MOU allowed, for the first time, extensive code-sharing between U.S. carriers, U.S. and Japanese carriers, and U.S. and third-country carriers on services between the United States and Japan and beyond Japan. On charters, the MOU provided for each party to use up to 600 charter flights per year beginning January 1, 2000. This will rise to 800 flights per year in 2002. Distribution and pricing provisions of the MOU promote competition, and Japan has guaranteed U.S. carriers fair and equal opportunity to contract with wholesalers and travel agents and set up enterprises to market their services directly to consumers.

According to the MOU, a new round of talks aimed at "Open Skies" is scheduled to begin by January 1, 2001. If these talks do not achieve a fully-liberalized agreement, additional benefits will take effect automatically on January 1, 2002. The Administration is committed to seek further liberalization in line with its global policy of promoting "Open Skies" to minimize government interference in civil aviation, and to provide full and equal opportunities for U.S. and foreign passenger and cargo carriers to compete in each other's market.

According to U.S. industry estimates, U.S. passengers should enjoy gains of $1.2 billion over four years, measured in terms of additional service in a more competitive market, as a result of the agreement. U.S. carriers are expected to earn additional revenue of just over $4 billion over four years, due in part to an anticipated increase in U.S.-carrier market share. U.S. industry also calculates that U.S. exports of aviation services should rise almost $4 billion over the next four years.

Implementation of the MOU proceeded smoothly in 1999. The economic slowdown in Japan and much of Asia affected U.S. carriers in Japan, though demand for frequencies and slots remained high. The scarcity of slots and inadequate facilities at Narita Airport (see below) was one blemish on the otherwise positive bilateral relationship, as some U.S. carriers complained they were unable to use all the rights granted them by the 1998 MOU because of lack of access to Tokyo's airport. Cooperative arrangements between U.S. and Japanese carriers expanded, most notably with ANA joining United Airlines' Star Alliance.

Narita Airport

The problem of scarce slots and inadequate facilities at Narita Airport became more acute in 1999. A longstanding negotiation on facility renovation and construction between a U.S. carrier and the Narita Airport Authority

collapsed in August when Airport officials retreated from an informal agreement made earlier in the year. This move by Narita officials further slowed completion of a comprehensive plan, spelled out under the informal 1994 "Master Plan," for renovating the older Narita Terminal used by most U.S. carriers. The airline and the U.S. Government have sought to resolve this dispute and increase the tempo of design and construction to previously-agreed levels. However, the Airport Authority has been reluctant to do so, even though improved facilities at the airport should benefit all parties. Some U.S. carriers have expressed concern that without additional slots and larger facilities at Narita – which compares unfavorably with major U.S. and Asian airports on both accounts – they will not be able to take full advantage of the current liberalized agreement or any future bilateral "Open Skies" agreement.

Direct Marketing

In recent years, direct marketing has become an increasingly popular way to sell housewares, personal care products, and health supplements in Japan at a discount compared to prices in local retail stores and has proved to be an effective means of distributing U.S. exports throughout Japan. Local distributors, who are largely part-time independent workers, such as housewives and older people, also can use direct marketing to supplement their family incomes. MITI regulates these activities through enforcement of consumer protection laws that prohibit fraudulent or misleading sales practices.

A $22 billion Japanese catalog sales market registered a small increase of about one percent in JFY 1998 after having marked a drop in the previous two years. As part of total direct marketing sales, Internet sales direct to consumers (B2C) are still small in terms of total sales (at $650 million in JFY 1998), but have expanded at a very fast-pace. The most successful B2C mall, Rakuten, now has 1,500 tenant shops (in December 1999) reaching monthly sales (total of all tenants) of $7 million. An optimistic industry forecast is a $32 billion market for B2C in 2003.

The Internet is changing the nature of the direct marketing business. Japanese B2C and B2B catalog sales are far behind those of the United States, partly because more personal attention by company sales agents were traditionally demanded by client companies in Japan. However, as Japanese business customers become more price-sensitive and are willing to switch to new suppliers, aided in part by improved online services and a reduction in telecommunication costs, they are more prone to switch to Internet shopping.

Electrical Utilities

The cost of electric power in Japan is the highest in the industrialized world. The United States believes that one of the most effective ways for Japan to reduce costs in this sector would be to introduce genuine competition into non-fuel procurement. Non-fuel procurement is presently valued at approximately $20 billion annually.

In general, many utility companies have made efforts to increase imports and reduce costs. In particular, they have increased the number of registered companies as potential suppliers and improved the level of procurement information accessible in Japanese and English through the Internet. Several utilities are actively participating in the New Orleans Association (NOA), a forum that enhances communication between the electric power firms and U.S. suppliers of non-fuel materials and equipment. However, the degree of effort varies by company and sector. Some firms have significantly improved procedures for international procurement, while others lag behind. Due to the introduction of competition in the power generation market, including liberalization of power wholesaling that started in 1996 (the retail market will undergo partial liberalization in March 2000), thermal power generation sectors are more enthusiastic about procuring materials and equipment globally. However, power transmission and substation sectors are more conservative in introducing new technology and are inclined to continue to procure from traditional domestic suppliers. They are less interested in improving their

procurement practices because they continue to be protected by a natural monopoly structure.

Utility companies in Japan have made notable efforts in expanding foreign procurement of telecommunications-related products. All of Japan's electric utility companies and their affiliated telecommunications subsidiaries have actively participated in U.S. Embassy sponsored and organized "Onsen Communication" purchasing seminars since 1994. These informal get-togethers enhance communication between the utilities and U.S. telecommunications equipment suppliers. U.S. firms have been awarded several dozen procurements worth hundreds of millions of dollars as a result of this program.

Foreign firms still face barriers in the standards and specifications used by Japanese utility companies that often discriminate against or otherwise disproportionately affect foreign suppliers. Problems remain in the use of narrow, dimension-based technical standards rather than performance-based technical standards, and requirements that suppliers provide detailed information for spare parts originating from outside sources. Although Government of Japan has moved toward performance-based standards since March 1997, the utilities' procurement methods have remained unchanged partially because procurement manuals need to be revised to reflect the new performance-based standards.

The United States also is seeking greater transparency and fairness in the procurement process. Costly and time-consuming procedures are generally required for a firm to be added to the list of designated suppliers for a particular utility company, including requests that suppliers submit detailed information on proprietary manufacturing processes. Equal access to procurement information also is a problem, and foreign firms often do not learn about procurements until after they have been awarded. In order to expand international procurement to reduce costs, it is important for the electric utilities to publish specifications in English and accept offer sheets, drawings, and explanatory documents, as well as contract sheets all in English.

The 10 regional power companies are annually investing approximately $40 billion, of which approximately 50 percent is being spent for construction work, and the remainder being spent for procurement of non-fuel materials and equipment. The electric power companies' procedures for procurement of construction work are not sufficiently transparent nor do they provide open access to foreign companies. Additionally, Japanese industry sources acknowledge that a percentage of money invested by electric power companies for the construction of power stations is used to foster political support for the industry.

Electric power companies are spending substantial amounts of money from the sale of electricity for research and development. A part of the R&D money is used to cover the expenses for selected university professors' research and overseas trips. Some university professors are invited to participate in MITI advisory council committees to discuss how future electric power supply systems should operate. In order to keep the discussions fair and neutral, those who have received financial support from the electric power companies should be excluded from participating.

Some new U.S. technologies, such as micro gas turbines, are being introduced in Japan. In order to cultivate healthy development of the new technology, Japan should carefully examine and eliminate possible barriers against import of these products.

Flat Glass

Flat glass is a classic example of Japan's resistance to open markets. Despite their extensive experience and success in other countries and many years of active efforts in Japan, U.S. flat glass manufacturers have failed to break the stranglehold of Japan's flat glass oligopoly.

Japan's flat glass industry has been hit hard by Japan's economic recession. Despite fluctuations in Japan's flat glass market over the past 30 years, the market share of the three domestic producers has remained virtually unchanged. They exert tight control of distribution channels in many ways, including majority ownership, equity and financing ties, employee exchanges, and purchasing quotas. At the same time, they change prices, capacity, and product mix in virtual lockstep, thereby maintaining their market shares with little variation. Through mid-1999, Asahi Flat Glass controlled over 40 percent of the market, Nippon Sheet approximately 30 percent, and Central Glass about 20 percent. Imports, including those by U.S. manufacturers, represent the remainder.

In January 1995, the United States and Japan concluded an agreement to open Japan's flat glass market to foreign suppliers. Pursuant to that agreement, Japanese glass distributors publicly stated that they would diversify supply sources to include competitive foreign glass suppliers, and that they would not discriminate among suppliers based on capital affiliation. Japanese glassmakers expressed support for diversifying their *de facto* exclusive distribution networks. The agreement also committed the Government of Japan to encourage the selection of flat glass for public works projects on a non-discriminatory basis and promote the use of insulated and safety glass, where American companies have superior products. An annual survey was undertaken under the agreement to assess the openness of the distribution system.

The agreement has had some important successes. For example, it resulted in Japan's adoption on March 30, 1999 of energy conservation standards for both residential and commercial buildings. These standards will raise the energy efficiency of glass installed in new residential structures by an average of 20 percent, and in commercial structures by 10 percent. The changes will result over time in increased demand for insulated glass, benefitting Japanese and American manufacturers alike. The agreement also prompted Japan to feature American glass in a number of high-profile public works projects.

However, important objectives remain unfulfilled. U.S. and other foreign glass manufacturers still have a minuscule share of Japan's flat glass market, despite the fact that Japanese firms and distributors readily acknowledge the high quality and lower cost of American glass. U.S. firms report that their market share of construction-related flat glass has not increased over the last four years. While MITI has claimed that the United States is the market leader in imported glass, with a steady increase in market share during the same period, their data include not only construction-related flat glass, but also automotive and other specialty glass imports, such as glass for liquid crystal display (LCD). U.S. industry points out that these non-construction-related products are irrelevant to the problems that gave rise to the agreement because they are sold through completely separate distribution systems. Foreign subsidiaries of Japanese manufactueres also supply Japan's flat glass market, and MITI counts these imports from Japanese affiliates abroad in their foreign market share estimates. Because Japanese affiliates overseas have privileged access to their parent companies' distribution systems, their sales to Japan reveal little about the market's openness. In total, foreign companies supply about seven percent of Japan's flat glass market; in most other major industrial markets, including the United States and the EU, the market share of foreign-owned companies (via imports and in-country production) is more than five times the level in Japan.

The domination by domestic flat glass manufacturers of local distributors shows no sign of abating. Indeed, there is evidence that it is on the rise. Manufacturers are using Japan's recession and the resulting tight credit market to strengthen their financial hold on the most important glass distributors. In some cases, they have assigned their own employees to run the distributorships. Moreover, certain Japanese manufacturers appear to be using aggressive

pricing strategies to dissuade distributors from handling foreign glass.

When alerted to these activities, the Japanese authorities cite a survey undertaken by the JFTC and published on May 20, 1999 that found no practices in violation of Japan's antitrust laws. Nevertheless, the JFTC noted the dominant position enjoyed by the three domestic firms in the flat glass market, pointed to a number areas of possible serious concern, and stated its intention to continue its surveillance of the industry. On December 21, 1999, the JFTC issued a formal decision against a Japanese auto glass association and a subsidiary of Japan's largest flat glass manufacturer, and issued warnings about the same behavior to three other industry associations. These organizations decided that members should not carry imported auto glass, and enforced that decision through threats of supply disruption for members who did not comply.

The U.S.-Japan Flat Glass Agreement expired on December 31, 1999. In order to address the remaining market access barriers in this sector, the United States and Japan plan to hold government-to-government discussions in March 2000, to be followed by a joint government/industry meeting later in the Spring.

Paper and Paper Products

In April 1992, the United States and Japan signed the "Measures to Increase Market Access for Paper Products," a five-year agreement aimed at substantially increasing access to Japan's market for paper products. The agreement committed the Government of Japan to encourage companies to increase imports of competitive foreign paper products; introduce transparent corporate procurement guidelines; encourage key end-user segments of the Japanese market to use foreign paper; and introduce Antimonopoly Law (AML) compliance programs. Japan also promised to provide assistance to foreign paper suppliers in the form of market information and low-interest loans. The agreement expired in April 1997.

Through 1999, there has been no meaningful increase in Japanese imports of paper and paperboard products, and the level of import penetration for paper and paperboard products in Japan remains the smallest in the industrialized world. A key problem, according to U.S. producers, is weak enforcement of Japan's AML and the existence of exclusionary business practices. U.S. negotiators have discussed competition issues affecting this sector under the Enhanced Initiative's structural issues working group, which takes up AML enforcement and competition policy.

Consumer Photographic Film and Paper

Foreign photographic film and paper manufacturers face a variety of obstacles that restrict access and sales of their products in Japan, the second largest film market in the world. These obstacles have prevented foreign firms from gaining access to the main distribution channels for film.

After an extensive investigation, initiated in response to a petition by Eastman Kodak Co. (Kodak), the USTR in June 1996 made a determination of unreasonable practices by the Government of Japan with respect to the sale and distribution of consumer photographic materials in Japan. The investigation showed that the Government of Japan built, supported, and tolerated a market structure that impedes U.S. exports of consumer photographic materials to Japan, and in which restrictive business practices occur that also obstruct exports of these products to Japan.

To address these concerns, the United States initiated dispute settlement procedures against Japan in the WTO, alleging that Japanese Government measures were inconsistent with the General Agreement on Tariffs and Trade (GATT). The EU and Mexico joined the United States as third parties to the case.

The WTO Panel on film issued its final report on January 30, 1998, and failed to find Japan in violation of its GATT obligations. The United States expressed serious disappointment with the findings, stating that the interim report sidestepped the core issues raised by the United States, particularly the combined effects of the numerous measures Japan imposed to protect its market.

On February 3, 1998, the Administration established an interagency monitoring and enforcement committee to review implementation of formal representations made by Japan to the WTO about efforts to ensure openness to imports of photographic film and paper into Japan. The monitoring and enforcement committee surveyed the Japanese photographic film and paper market and assessed information and data obtained from U.S. and other foreign film manufacturers and the Government of Japan. The committee issued its second semi-annual report in June 1999.

Overall, the report welcomed positive steps taken by Japan to help make its photographic film and paper market more competitive during the September 1998 to April 1999 reporting period. For example, in a move to enforce the Antimonopoly Law (AML) and promote competition policy, the JFTC issued a public warning to Japan's Photosensitive Materials Manufacturers Association, directing it and its members to cease their exchange of production, sales, and inventory data, which the JFTC found to be a potential violation of the AML. During the reporting period, the JFTC also implemented specific changes to improve the transparency of its application of the Premiums Law. This should help to ensure that the law is not improperly used to restrict retail competition. Further, related to distribution, the report noted MITI plans to enhance the quality and efficiency of Japan's distribution system.

Despite these positive moves, the report outlined additional steps for Japan to undertake to ensure that its representations to the WTO are reflected in the Japanese market. The United States continues to receive reports of problematic business practices, such as the disruption in deliveries to retailers who promote competing brands of photographic film and paper by Fuji distributors, and offering of low wholesale film prices only to those retailers who agree to exclusive sales of Fuji film. These allegations warrant further follow-up by the JFTC. Within this context and under the Enhanced Initiative, the United States has urged Japan to establish a strong competition policy framework that provides the JFTC with the resources necessary to actively enforce the AML and advocate competition policy. The June report also noted the important role MITI can play in further opening Japan's distribution system and to prohibit practices that discourage the opening of large stores. As large stores are a key and growing sales channel for foreign firms, including film manufacturers, the implementation of the new Large-Scale Retail Store Location Law (LSRSLL), which will become effective in June 2000, is of great interest to the United States. The U.S. Government continues to work closely with Japan to ensure that the new legal regime is not overly burdensome on large store openers.

The committee will release its next semi-annual film monitoring report in the Spring of 2000. Preliminary data being analyzed by the committee reveal continued access barriers to this part of Japan's market. A 1999 Kodak-commissioned survey assessing trends in the Japanese photographic film and paper market found that Kodak products were available in 44 percent of Japanese stores surveyed. The survey concluded that Kodak products continue to be more likely to be found and to be offered most competitively in non-traditional stores, such as discount stores, supermarkets, and convenience stores. This further emphasizes the importance of U.S. efforts under the Enhanced Initiative and elsewhere to ensure vigorous Japanese efforts to enforce the AML, non-discriminatory

implementation of the LSRSLL, and further opening of Japan's distribution channels.

The monitoring and enforcement committee continues to scrutinize closely foreign access to Japan's film market and Japan's efforts to open this market in accordance with its WTO representations.

Sea Transport and Freight

American carriers serving Japanese ports have encountered for many years a restrictive, inefficient and discriminatory system of port transportation services. Following extensive research and deliberation, the Federal Maritime Commission (FMC) determined in February 1997 that Japan maintained unfair port practices and proposed fines against Japanese ocean freight operators. The FMC delayed implementation of the fines after the United States and Japan reached an understanding in April 1997, under which Japan pledged to grant foreign carriers port transport licenses and, at the same time, to reform the prior consultation system, which allocates work on the waterfront and requires carriers to obtain approval for any change in their vessel operations.

Japan's failure to carry out these reforms by July 31, 1997 resulted in FMC implementation of fines on September 4, 1997. The United States and Japan reached an understanding in October 1997, which was recognized in an exchange of letters between Secretary of State Albright and then-Japanese Ambassador Saito. The understanding noted two agreements among the Government of Japan, foreign shipowners, Japanese ship owners and the Japan Harbor Transport Association, in which they committed to improve the prior consultation system, and to establish an alternative method to the system. The Ministry of Transport also agreed to approve foreign carriers' applications for harbor services licenses if those applications satisfied the requirements set out in the April understanding. The United States believes that these actions provide a solid foundation for reform of Japan's port practices. Sanctions were suspended on November 13, 1997. The United States continues to vigorously monitor the agreement to ensure its full implementation.

The Harbor Transport Subcommittee of the Ministry of Transport, which was tasked with preparing recommendations for deregulation, published its final report in June 1999. While encouraged by some aspects of the report – especially the elimination of the supply-demand adjustment requirement – the United States expressed strong concerns about the report's failure to promote real competition on the docks and the addition of new regulations. Key issues of concern include an increase in the minimum manning requirement and the request for "voluntary" contributions by shippers and carriers to the port workers' pension and welfare fund. Though the report does not meet its expectations, the United States will closely monitor the Ministry of Transport's efforts to draft and support deregulation legislation based on the final report. Additionally, the United States will continue to encourage Japan to live up to commitments made in the 1997 Albright-Saito exchange.

Motorcycles

Japan maintains two restrictions on the use of large-class motorcycles that artificially limit the market for large-class motorcycles in Japan, adversely affecting U.S. exports. These restrictions, which are contained in the Road Traffic Law, include the prohibition of tandem riding (i.e., carrying a passenger) on motorways, and the lower speed limit applied to motorcycles and mini-cars vis-à-vis the standard speed limit for other motor vehicles. In March 1994, the United States first appealed to Japan to remove these burdensome restrictions on the grounds that they are unnecessary and, in fact, detract from highway safety.

On the speed limit issue, a large volume of traffic research shows that accident risks are greater for vehicles traveling either faster or slower than the rest of the traffic stream. Thus, by requiring motorcycles to observe a lower speed limit than automobiles, current law increases accident risk. Finally, in March 1999, Japan decided to investigate "whether it is advisable to increase the maximum speed limit on motorways for mini-cars and motorcycles to 100km/hour." If, after the conclusion of their study (anticipated by late March 2000), Japan determines that there are no particular problems with unifying the speed limit, the United States has requested that Japan put into place procedures to unify the speed limit on Japanese motorways in a timely fashion.

On tandem riding, the United States filed a petition with Japan's Office of Trade and Investment Ombudsman (OTO) in June 1999 once again seeking to lift the ban on tandem riding of motorcycles on motorways. To support its petition, the United States also presented testimony and evidence at a November 1999 OTO hearing on the issue. This evidence showed that motorways are safer than ordinary roads, and that passenger-carrying motorcycles have a much better safety record than single-rider motorcycles. Thus, because the current law requires motorcycles with passengers to travel on less-safe non-motorway roads, it raises accident risk. The OTO and Government of Japan are currently considering the U.S. petition.

Semiconductors

One area in which the Governments of the United States and Japan have made progress in addressing trade problems is semiconductors. After many years of effort by both Governments as well as their respective semiconductor industries, substantial progress has been achieved in both the level of industry cooperation and market access. Japanese purchases of foreign chips have consistently exceeded 30 percent for several years. The 1996 bilateral semiconductor agreement expired on July 31, 1999 and was replaced by a multilateral Joint Statement on Semiconductors announced by the United States, Japan, Korea, and the European Commission. The new statement is designed to ensure fair and open global trade in semiconductors and includes the essential elements of the 1996 accord, such as regular meetings among governments and between government and industry representatives. The United States will, however, continue to monitor foreign market share in the Japanese market on a quarterly basis, and once a year will report the average foreign share in the Department of Commerce "U.S. Industry and Trade Outlook."

Steel

The U.S. steel industry endured tremendous hardship in 1998 as a sudden and substantial drop in demand for steel in Japan and the rest of Asia created a huge oversupply, much of which Japanese companies diverted to the U.S. market. Japan was the main source of imports to the U.S. market in 1998. While U.S. imports of steel from Japan in 1999 were down significantly from 1998 levels, the underlying causes of the surge should be addressed to ensure that this is not repeated in the future.

In August 1999, the President announced that the Administration would undertake bilateral initiatives with steel exporting nations, including Japan, to address a broad range of practices that support economically unjustifiable capacity. The United States launched a dialogue with Japan in September 1999. The objectives are to review conditions of steel industries in the two countries, promote market-based trade in a competitive environment, and exchange views on policies affecting the steel industries in the two countries, and on possible approaches to global overcapacity through multilateral fora.

The United States has used the bilateral dialogue to raise its concerns, especially regarding

possible obstacles to competition and restructuring in Japan's steel market. Concerns include: relatively low import competition in Japan; relatively high prices in Japan (based on published data); and the use of government policy and laws (such as the Business Reform Law and Industrial Revitalization Law) to support the steel sector on an ongoing basis, without simultaneously requiring restructuring or increased competition.

U.S. steel producers often have expressed concerns that Japanese steel companies may be engaging in anti-competitive practices. With respect to Japan's domestic market, it is alleged that Japan's five integrated producers coordinate output, pricing, and market allocation goals – all with the knowledge of MITI. In addition, it is alleged that Japanese mills have entered into a series of arrangements with foreign counterparts to regulate bilateral steel trade. Furthermore, the United States is concerned by major integrated steel producers' tight control over steel distribution channels in a manner which strongly discourages imports. These alleged practices could explain the fact that the market shares of Japan's five large mills have remained stable over the last three decades. The United States has expressed concerns about these alleged activities to Japanese officials and has urged them to vigorously and effectively deal with any such activities. The United States will continue to actively address any anti-competitive activity, market access barriers, or market distorting trade practices in the steel sector.